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Bloomberg BusinessWeek

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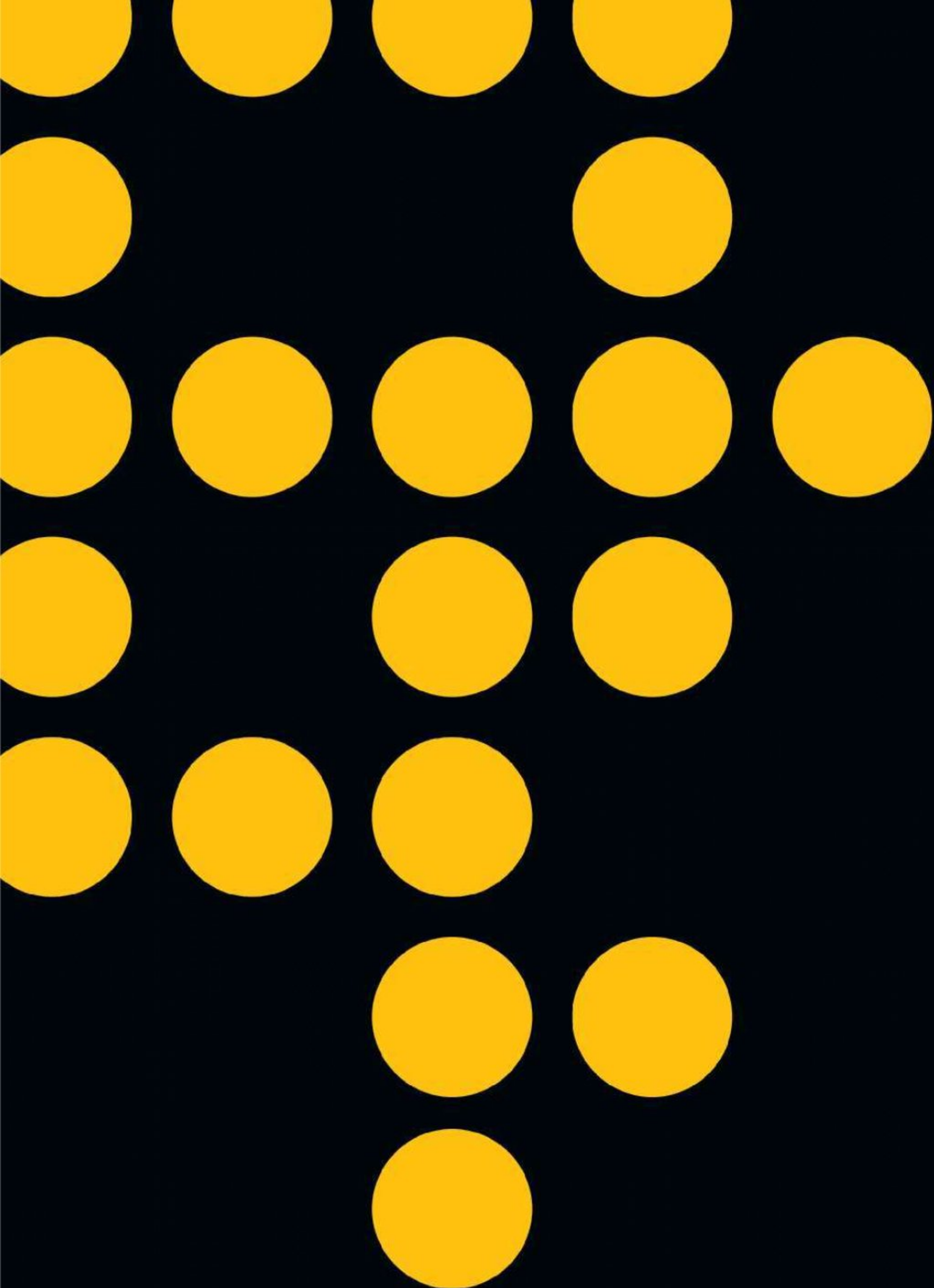
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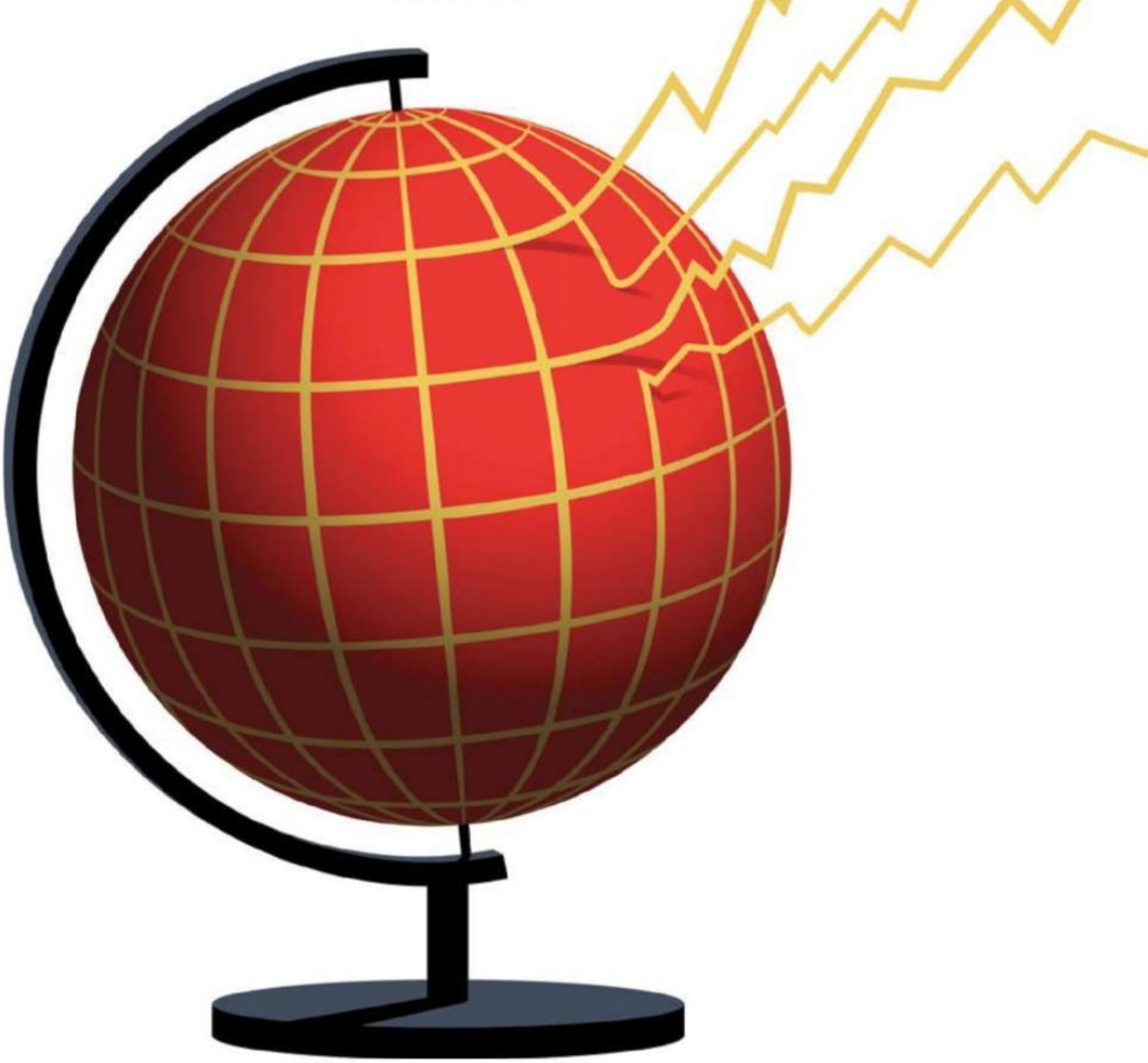
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MANY HAPPIER RETURNS

It was the best of times, it was the verse of times. *BusinessWeek*'s Marc Miller takes a bard's eye view of the flips, flaps, and flops of a year you might want to forget. | BW | PAGE 042



FACEBOOK WANTS YOUR I.D.

The social media site is eager to be the issuer of digital calling cards that identify you anywhere you go on the Web. But the whole notion makes privacy advocates nervous. | BW | PAGE 092

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(L TO R) ILLUSTRATION BY MICHAEL WITTE; PHOTOGRAPH BY MARKHAM JOHNSON

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THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD

ECONOMICS & POLICY

JAWBONING THE BANKS

"I did not run for office to be helping out a bunch of fat-cat bankers on Wall Street." That's what **Barack Obama** told *60 Minutes* the day before a Dec. 14 session with leaders of 12 big banks. Obama summoned the financiers to express his frustration with their skimpy level of lending. At the meeting, the bankers obediently said they'd lend more and personally back reform. One version of such a bill passed the House on Dec. 11, featuring a **Consumer Financial Protection Agency** and imposing new fees and capital requirements on big banks.

But the Administration is rapidly losing leverage. Both **Citigroup** and **Wells Fargo** announced plans to repay $20 billion and $25 billion in TARP bailout money, respectively, issuing new shares to raise capital and shaking off Washington controls. While many analysts fear that Citi in particular isn't ready to fly solo, the White House gave its blessing. Maybe the economy will cooperate: At its rate-setting meeting on Dec. 16, the **Fed** offered its most upbeat evaluation in months and left rates at near-zero.

Meanwhile, Bank of America tapped **Brian Moynihan,** head of the lender's consumer banking unit, as its next CEO.

|BW| PAGE 024 "Prodding Banks Without a Stick"

ABU DHABI TO THE RESCUE

Faced with the prospect of imminent default by a company closely linked to the government of **Dubai,** deep-pocketed Abu Dhabi had little choice but to pony up $10 billion to assist its fellow emirate. Part of the sum will help pay a $4.1 billion Islamic bond for **Nakheel,** the real estate subsidiary of **Dubai World.** That brings Abu Dhabi's bailout total to $25 billion—and Dubai isn't out of the desert yet.



C'mon now, *lend*: Obama appealed to bankers on Dec. 14

DOUG MILLS/THE NEW YORK TIMES/REDUX

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The emirate may need to restructure more than $40 billion in debt, and the price it will pay for the lifeline is not clear. Analysts speculate that Abu Dhabi may demand a stronger say in Dubai's financial management or grab stakes in key companies such as **Emirates** airline and **Dubai Aluminum.** Meanwhile, **Citigroup** said on Dec. 16 that the **Abu Dhabi Investment Authority** had filed an arbitration claim trying to abort a 2007 agreement to buy $7.5 billion of Citi stock at eight times today's price. ADIA is seeking $4 billion in damages if the deal is upheld, Bloomberg reported. Citi said the claim had no merit, while ADIA said it would "pursue its legal rights fully."

CHINA LEADS U.S. IN IPOs

AMOUNTS RAISED FROM INITIAL OFFERINGS THIS YEAR



Data: Dealogic

PHOTOGRAPH BY KARIM SAHIB/AFP/GETTY IMAGES; CHART BY DAVID FOSTER/BW

Abu Dhabi stepped in to help Nakheel pay off $4.1 billion

"Abu Dhabi May Wrest Power from Dubai" businessweek.com/magazine

PUBLIC OPTION, R.I.P.?

For now, the fate of health-care reform appears to hang on the vote of one person: **Senator Joe Lieberman,** the Connecticut independent. On Dec. 14, Lieberman derailed a compromise pieced together by **Senate Majority Leader Harry Reid.** Lieberman said he would withhold his crucial 60th vote because the bill contained both a watered-down public insurer option and a Medicare buy-in option—though he had supported both policies months earlier. The Democrats axed the proposals, alienating liberals and many House members. The compromised compromise will likely come to the floor during Christmas week.

EUROPEAN JITTERS

Two strapped European nations presented plans to tame their raging deficits—one to cheers, the other to jeers. **Ireland** on Dec. 10

Welcome to 4G. Laptops, prepare for liftoff. Get ready, America. The first and only wireless 4G network from a national carrier is arriving. Get amazing 3G speeds today and record-breaking 4G speeds tomorrow. Welcome to the Now Network.™ 1-800-SPRINT-1 sprint.com/4G

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pledged to slash its 12%-of-GDP deficit, four times the **European Union's** agreed limit, to 3% by 2013—and backed the pledge with severe spending cuts. Four days later, **Greek Prime Minister George Papandreou** promised to cut his country's deficit, now at 12.7%, to 3% by 2013, but his speech was short on concrete measures, so investors continued to dump Greek bonds. On top of that, **Austria** on Dec. 14 seized its failing, sixth-largest lender, **Hypo Group Alpe Adria.** All the jitters combined to drive the euro down to $1.45, its lowest since October.



Boeing's 787 Dreamliner finally takes off after two years of costly postponements

STRATEGY

THE DREAMLINER FLIES

It took more than two years, but **Boeing's 787 Dreamliner** finally got off the ground. (Although the first test flight, around Seattle on Dec. 15, was cut short by foul weather.) Now comes a rigorous testing program over the coming year to obtain government certification ahead of a planned delivery in late 2010 to launch customer **All Nippon Airways**. The plane promises to reduce fuel burn by about 20% over existing models because of its lighter carbon-fiber frame. That has made the 787 the hottest new model in Boeing history, with 840 firm orders.

EXXON GOES FOR GAS

ExxonMobil CEO Rex Tillerson suggests it may take

IDEAS DID SAMUELSON'S FOLLOWERS GO ASTRAY?

By any measure, **Paul Samuelson** was a giant in the field of economics. The Nobel laureate, who died on Dec. 12 at the age of 94, is widely credited with bringing mathematical rigor to the dismal science. But a pair of economists at **Middlebury College** argue that his legacy "has paralyzed the best brains in the Anglo-Saxon branch of the profession for the last three decades."

Don't blame the professor—blame his pupils. In a forthcoming paper, "Sins of the Sons of Samuelson," **David Colander** and **Casey Rothschild** explain that Samuelson's sensibility was shaped by his training in classical economics. He viewed the economy as a complex system in which models could only be used as aids to judgment, not as direct guides to the real world. Succeeding generations, however, became enamored of the models themselves, to the point that "more and more economists came to believe that if an idea couldn't be reduced to a mathematical model ... it probably wasn't worth knowing," say the authors. This loss of historical perspective, they argue, is one of the reasons that most economists didn't see the financial crisis coming.

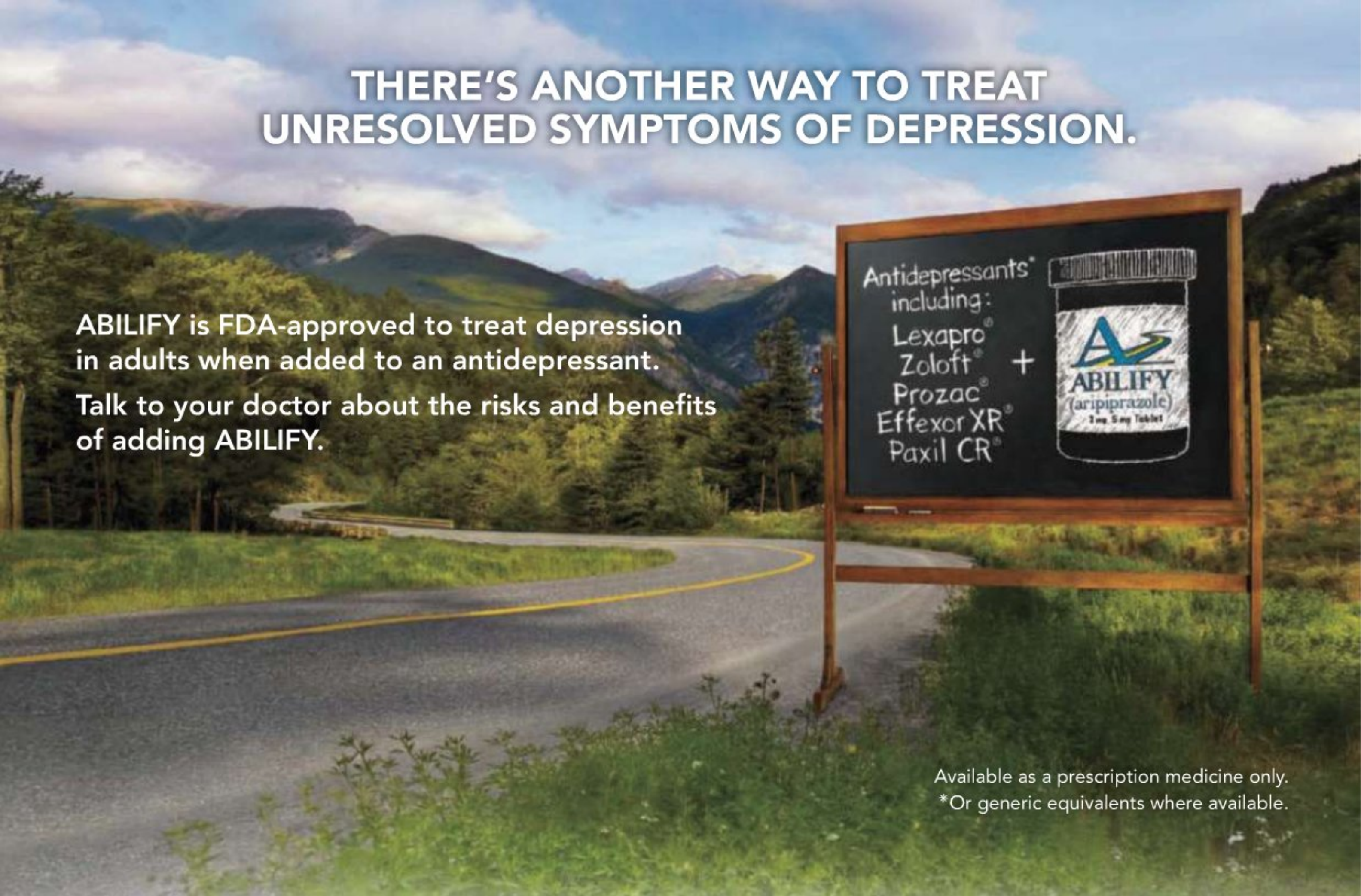
⊵ "Sins of the Sons of Samuelson," David Colander and Casey Rothschild



Samuelson with members of his MIT staff after winning the Nobel prize in 1970

(FROM TOP) KEVIN P. CASEY/BLOOMBERG; BETTMANN/CORBIS

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IMPORTANT SAFETY INFORMATION:

Elderly patients with dementia-related psychosis (eg, an inability to perform daily activities due to increased memory loss) taking ABILIFY have an increased risk of death or stroke. ABILIFY is not approved for treating these patients.

Antidepressants can increase suicidal thoughts and behaviors in children, teens, and young adults. Serious mental illnesses are themselves associated with an increase in the risk of suicide. When taking ABILIFY call your doctor right away if you have new or worsening depression symptoms, unusual changes in behavior, or thoughts of suicide. Patients and their caregivers should be especially observant within the first few months of treatment or after a change in dose. Approved only for adults 18 and over with depression.

- Call your doctor if you develop very high fever, rigid muscles, shaking, confusion, sweating, or increased heart rate and blood pressure, as these may be signs of a rare but potentially fatal condition called **neuroleptic malignant syndrome (NMS)**
- If you develop abnormal or uncontrollable facial movements, tell your doctor, as these may be signs of **tardive dyskinesia (TD)**, which could become permanent
- If you have **diabetes** or have risk factors or symptoms of diabetes, your blood sugar should be monitored. High blood sugar has been reported with ABILIFY and medicines like it. In some cases, extreme high blood sugar can lead to coma or death
- **Other risks** may include lightheadedness upon standing, decreases in white blood cells (which can be serious), seizures, trouble swallowing, or impairment in judgment or motor skills. Until you know how ABILIFY affects you, you should not drive or operate machinery

The **common side effects** in adults in clinical trials (≥10%) include nausea, vomiting, constipation, headache, dizziness, an inner sense of restlessness or need to move (akathisia), anxiety, and insomnia. Tell your doctor about all the medicines you're taking, since there are some risks for drug interactions. You should avoid alcohol while taking ABILIFY.

You are encouraged to report negative side effects of prescription drugs to the FDA. Visit www.fda.gov/medwatch, or call 1-800-FDA-1088.

Please read the additional Important Information about ABILIFY on the adjacent page.

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ABILIFY® (aripiprazole) 2, 5, 10, 15, 20, 30 mg Tablets

IMPORTANT INFORMATION ABOUT ABILIFY

This summary of the Package Insert contains risk and safety information for patients about ABILIFY. This summary does not include all information about ABILIFY and is not meant to take the place of discussions with your healthcare professional about your treatment. Please read this important information carefully before you start taking ABILIFY and discuss any questions about ABILIFY with your healthcare professional.

Name

ABILIFY® (a-BIL-ĭ-fī) (aripiprazole) (air-rĭ-PIP-ra-zall)

What is ABILIFY?

ABILIFY (aripiprazole) is a prescription medicine used as an add-on treatment to antidepressants for Major Depressive Disorder in adults.

What is depression?

Depression is a common but serious medical condition. Symptoms may include sadness, loss of interest in activities you once enjoyed, loss of energy, difficulty concentrating or making decisions, feelings of worthlessness or excessive guilt, insomnia or excessive sleep, a change in appetite causing weight loss or gain, or thoughts of death or suicide. These could be depression symptoms if they interfere with daily life at home, at work, or with friends and last most of the day, nearly every day for at least 2 weeks.

What is the most important information that I should know about antidepressant medicines, depression, and other serious mental illnesses?

- Antidepressant medicines may increase suicidal thoughts or actions in some children, teenagers, and young adults
- Depression and serious mental illnesses are the most important causes of suicidal thoughts and actions

For more information, see the Prescribing Information and the Medication Guide called *Antidepressant Medicines, Depression and Other Serious Mental Illnesses, and Suicidal Thoughts or Actions.*

Who should NOT take ABILIFY?

People who are allergic to ABILIFY or to any substance that is in it. Allergic reactions have ranged from rash, hives and itching to difficulty breathing and swelling of the face, lips, or tongue. Please talk with your healthcare professional.

What is the most important information that I should know about ABILIFY?

Elderly patients, diagnosed with psychosis as a result of dementia (for example, an inability to perform daily activities as a result of increased memory loss), and who are treated with antipsychotic medicines including ABILIFY, are at an increased risk of death when compared to patients who are treated with a placebo (sugar pill). ABILIFY is not approved for the treatment of patients with dementia-related psychosis.

Antidepressants may increase suicidal thoughts or behaviors in some children, teenagers, and young adults, especially within the first few months of treatment or when the dose is changed. Depression and other serious mental illnesses are themselves associated with an increase in the risk of suicide. Patients on antidepressants and their families or caregivers should watch for new or worsening depression symptoms, unusual changes in behavior, or thoughts of suicide. Such symptoms should be reported to the patient's healthcare professional right away, especially if they are severe or occur suddenly. ABILIFY is not approved for use in pediatric patients with depression.

Serious side effects can occur with any antipsychotic medicine, including ABILIFY. Tell your healthcare professional right away if you have any conditions or side effects, including the following:

Stroke or ministroke in elderly patients with dementia: An increased risk of stroke and ministroke has been reported in clinical studies of elderly patients with dementia (for example, increased memory loss and inability to perform daily activities). ABILIFY (aripiprazole) is not approved for treating patients with dementia.

Neuroleptic malignant syndrome (NMS): Very high fever, rigid muscles, shaking, confusion, sweating, or increased heart rate and blood pressure **may be signs of NMS, a rare but serious side effect that could be fatal.**

Tardive dyskinesia (TD): Abnormal or uncontrollable movements of face, tongue, or other parts of body may be signs of a serious condition known as TD, which may be permanent.

High blood sugar and diabetes: Patients with diabetes and those having risk factors for diabetes (for example, obesity, family history of diabetes), as well as those with symptoms such as unexpected increases in thirst, urination, or hunger should have their blood sugar levels checked before and during treatment. Increases in blood sugar levels (hyperglycemia), in some cases serious and associated with coma or death, have been reported in patients taking ABILIFY, and medicines like it.

Orthostatic hypotension: Lightheadedness or faintness caused by a sudden change in heart rate and blood pressure when rising too quickly from a sitting or lying position (orthostatic hypotension) has been reported with ABILIFY.

Leukopenia, Neutropenia, and Agranulocytosis: Decreases in white blood cells (infection fighting cells) have been reported in some patients taking antipsychotic agents, including ABILIFY. Patients with a history of a significant decrease in white blood cell (WBC) count or who have experienced a low WBC due to drug therapy should have their blood tested and monitored during the first few months of therapy.

Suicidal thoughts: If you have suicidal thoughts, you should tell your healthcare professional right away.

Dysphagia: Medicines like ABILIFY have been associated with swallowing problems (dysphagia). If you had or have swallowing problems, you should tell your healthcare professional.

What should I talk to my healthcare provider about?

Patients and their families or caregivers should watch for new or worsening depression symptoms, unusual changes in behavior and thoughts of suicide, as well as for anxiety, agitation, panic attacks, difficulty sleeping, irritability, hostility, aggressiveness, impulsivity, restlessness, or extreme hyperactivity. Call your healthcare provider right away if you have thoughts of suicide or if any of these symptoms are severe or occur suddenly. Be especially observant within the first few months of antidepressant treatment or whenever there is a change in dose.

Tell your healthcare provider about any medical conditions you may have and all medicines that you are taking or plan to take, including prescription and over-the-counter medicines, vitamins, or herbal products.

Be sure to tell your healthcare provider:

- If you have suicidal thoughts
- If you have or have had a low white blood cell count (WBC)
- If you or anyone in your family have or had seizures
- If you or anyone in your family have or had high blood sugar or diabetes
- If you are pregnant, plan to become pregnant, or are breast-feeding

What should I avoid when taking ABILIFY?

- Avoid overheating and dehydration
- Avoid driving or operating hazardous machinery until you know how ABILIFY affects you
- Avoid drinking alcohol
- Avoid breast-feeding an infant

What are the possible side effects of ABILIFY (aripiprazole)?

Common side effects in adults include: nausea, vomiting, constipation, headache, dizziness, an inner sense of restlessness or need to move (akathisia), anxiety and insomnia.

It is important to contact your healthcare professional if you experience prolonged, abnormal muscle spasm or contraction which may be signs of a condition called dystonia.

This is not a complete list of side effects. For full patient information, visit www.abilify.com. Talk to your healthcare professional if you have questions or develop any side effects.

What percentage of people stopped taking ABILIFY due to side effects?

In clinical trials, the percentage of adults who discontinued taking ABILIFY due to side effects was 6% and 2% for patients treated with sugar pill.

Can I safely take ABILIFY while I'm taking other medications?

ABILIFY can be taken with most drugs; however, taking ABILIFY with some medicines may require your healthcare professional to adjust the dosage of ABILIFY.

Some medicines* include:

- ketoconazole (NIZORAL®)
- quinidine (QUINIDEX®)
- fluoxetine (PROZAC®)
- paroxetine (PAXIL®)
- carbamazepine (TEGRETOL®)

It is important to tell your healthcare professional about all the medicines you're taking, just to be sure.

How should I take ABILIFY?

- Take ABILIFY exactly as directed by your healthcare professional
- ABILIFY is usually taken once a day and can be taken with or without food
- If you miss a dose, take it as soon as you remember. However, if it is time for your next dose, skip the missed dose and take only your regularly scheduled dose
- Talk to your healthcare professional before stopping ABILIFY or changing your dose

General advice about ABILIFY:

- ABILIFY should be kept out of the reach of children and pets
- Store ABILIFY Tablets and the Oral Solution at room temperature
- For patients who must limit their sugar intake, be aware that **ABILIFY Oral Solution contains sugar**
- For patients who cannot metabolize phenylalanine (those with phenylketonuria or PKU), **ABILIFY DISCMELT® contains phenylalanine**
- If you have additional questions, talk to your healthcare professional

Find out more about ABILIFY:

Additional information can be found at **www.abilify.com**

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U.S. Patent Nos. 5,006,528; 6,977,257; and 7,115,587.

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EXECUTIVE SUMMARY



An Intel booth at a trade show: The chip giant faces antitrust charges

awhile before the wisdom of his Dec. 14, $41 billion acquisition of **XTO Energy** is obvious. XTO drills for "shale gas," a type of fuel obtained by injecting huge amounts of water and chemicals into hard subterranean rock. While natural gas is viewed as an ideal bridge fuel until alternative energy has a chance to develop, there's rising concern among environmentalists about the production technique fouling groundwater. "We'll probably suffer a little bit in the near term as we put [the companies] together," Tillerson told analysts. "This is really about value creation over the next many years."

| BW | PAGE 030 "Exxon Buys a Green Headache"

TECHNOLOGY

ANTITRUST PATROL

Notch a win and a loss for the so-called Wintel PC duopoly. **European Commission** regulators on Dec. 16 ended an 11-year struggle with **Microsoft,** settling remaining antitrust issues after the company agreed to offer rival browsers alongside **Internet Explorer.** But the same day, after a long investigation, the U.S. **FTC** accused chip behemoth **Intel** of using its dominant position to shut out competitors, saying Intel has been "running roughshod over the principles of fair play." The chipmaker fired back that the FTC is trying to write new rules for curbing business. That line of defense may prove a hard sell: Regulators in Asia and Europe have fined Intel more than $1 billion because of pricing incentives that reward PC makers for using its chips.

GOOGLE CALLING

Is the 800-pound search gorilla about to take on the cell-phone giants? Google has given some staffers a touch-screen device to try out, igniting speculation that early next year it will offer consumers a cell phone directly and through carrier **T-Mobile USA.** That could pit Google not only against **Apple's iPhone** but also against allies like **Motorola, Samsung,** and **Sony Ericsson,** which have adopted **Android,** mobile-phone software that Google helped create.

| BW | PAGE 022 "A Google Phone May Dial Up Trouble"

Samsung's Choi: It's unusual for the company to name a non-engineer as CEO



LEADERSHIP

SHAKEUP AT SAMSUNG

South Korea's largest company, **Samsung Electronics,** short-circuited tradition on Dec. 15 by elevating a design and marketing guy rather than an engineer to the corner office. **Choi Gee Sung,** head of the TV and cell-phone business, becomes CEO, and **Lee Jae Yong** (also known as **Jay Y. Lee**), the only son of former **Chairman Lee Kun Hee,** assumes the new post of COO. Analysts describe the move as part of a plan to place the scion of the founding Lee family at the controls.

"Apple Envy Drives Samsung Shakeup" businessweek.com/magazine

THE OPTIMISM METER

THE BULLS GET HAPPY



The Meter climbed to 48 on Dec. 15, up from 44 a week earlier, despite a downbeat outlook for the U.S. job market. That's mainly because of increasing bullishness as stock-market volatility neared a low not seen since August 2008. Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov**, the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts. It tracks shifts in outlook among individuals, professional investors, and economists about jobs, markets, and growth.

*Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest
Data: YouGov, *Bloomberg BusinessWeek*

(FROM TOP) NICKY LOH/REUTERS; LLUIS GENE/AFP/GETTY IMAGES

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FACETIME | DIANE BRADY





STEPHEN VOSS

KEN FEINBERG THE PAY CZAR ON THE END OF HIS EMPIRE

As the Obama Administration's compensation czar, Ken Feinberg is trying to curb outsize pay at companies receiving bailout funds while making sure they retain sufficient talent to pay the government back. On Dec. 14, Citigroup worked out a deal to exit the Troubled Asset Relief Program, becoming the last bank to escape his direct control. Later that day, Senior Editor Diane Brady spoke with Feinberg about the challenges he faced and the impact of his efforts. Here are excerpts from the interview.

DIANE BRADY
How does it feel to have so many TARP recipients racing to repay the money?

KENNETH FEINBERG
It feels wonderful. It was always our understanding, emphasized by the Treasury Secretary, that the first and foremost priority was to get the taxpayers' money back.

So was part of the motivation in clamping down on pay a desire to inspire these banks to pay back the money as quickly as possible?
Our motivation in clamping down on compensation was, first, to bring compensation in line with the economic realities in this country. It's not just the dollars that are important. It's the method of paying: less cash and base salary, more stock over a longer period

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of time, pay tied to performance, no guarantees, no promises.

Does it bother you that the banks now have free rein when it comes to paying their people?
No! That's always been the goal—to pay back the taxpayer. We don't want to micromanage these companies.


Feinburg in 2002 listening to families of 9/11 victims tell their stories

How did you come up with the $500,000 pay cap? Were there some metrics around that, or did it just feel like the right amount?
The $500,000 came from a wide variety of sources. The President mentioned it at one point, I believe, or Secretary [Tim] Geithner. We did some economic studies. We asked for some comparative data. And we got some comfort, empirically, that it was about right.

AIG is an interesting case. It has had a talent exodus.
There has been an exodus of personnel. I leave it to AIG to decide whether it's talent or not. I'm very mindful of the concern expressed, not only by AIG but by the Federal Reserve and by the Treasury, that AIG is in danger of losing important people.

On compensation: "I don't think it's appropriate ... for government to interfere with the private marketplace"

Didn't some of the top execs threaten to leave when faced with the pay cap? Is that a case where you took a position and then had to backtrack?
No. I think that's incorrect. I've made some decisions based on input from the company, from the Fed, the Treasury. The Fed and the Treasury have no agenda other than to make sure AIG thrives financially.

What about Bank of America? Do you think its search for a CEO has been imperiled by the pay restrictions you placed on it?
You'll have to ask them. I can't tell you how the pay determination and my oversight has hindered or helped in their search for a CEO. [As *BusinessWeek* went to press, BofA insider Brian Moynihan was nameed CEO.]

Both the U.K. and France have imposed broad-based taxes on bankers' bonuses. Would that work here?
I'm not sure if the British model or the French model makes sense or not as public policy. But I do like the idea of leading European governments attempting to deal with the problem. It's what the Treasury Secretary urged in a meeting with the G-20—a systematic attempt to rein in excessive compensation.

Would you do the same thing if you could?
I'm not an expert on taxation so I can't talk about the merits of that approach.

Where do you see this all going? Do you think you can fundamentally reset executive pay, or are we headed back to business as usual?
Who can say for sure? I would hope Corporate America has learned from this financial crisis.

What have *you* learned through this process?
What I've learned is the extraordinary gap in perception between Wall Street and Main Street.

That's what has some people so outraged right now: They look at Bank of America and Citi repaying the money and they aren't saying: "Isn't it great that we're getting our money back?" They see it as a cynical maneuver, a way to clear the decks so bankers can go back to enriching themselves with hefty bonuses.
It is a misperception. I think that one would be well advised to acknowledge the importance of repayment. That is a return on the promise to repay when the taxpayers saved these companies.

What if we didn't own these companies? Do you think government should have any say over pay?
Absolutely not. In this capitalist system, which has worked on and off for more than 200 years, I don't think it's appropriate or sound for government to interfere with the private marketplace when it comes to compensation.

But you were complimentary of the moves Britain and France are making.
My compliment about Britain and France was not about the tax proposal but the fact that they're doing something to deal with excessive compensation.

You've worked on some tough assignments—remedies for soldiers exposed to Agent Orange, negotiating settlements for the families of September 11 victims. How does this experience compare with those?
There will never be anything as traumatic as the 9/11 fund. For 33 months, I was hearing about these tragedies. Nothing compares with that. BW

G. PAUL BURNETT/THE NEW YORK TIMES/REDUX

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BUSINESS OUTLOOK | RICH MILLER



WHEN GROWTH DOESN'T PAY THE BILLS

The recession may be over, but with unemployment remaining stubbornly high, the U.S. could be facing the same jobless sclerosis that plagued Europe in the '80s

The last time unemployment was this high was in the early 1980s after a quadrupling of oil prices helped drive the world economy into recession. A recovery later in the decade brought some relief, and by the end of the 1980s, joblessness in the U.S. was half what it was at its peak. Europe, though, was not so fortunate. Unemployment throughout much of the region remained stubbornly high even as economic growth resumed. The malaise was so unusual that Herbert Giersch, former president of Germany's Kiel Institute for the World Economy, coined a term for it: eurosclerosis.

Now, there's a real danger that the U.S. will develop its own case of that debilitating disease. Sure, the economy is picking up steam. Growth in the fourth quarter could come in as high as an annualized 4.5%. Yet unemployment looks set to stay at nosebleed levels, averaging 10% in 2010 and 9.2% in 2011, according to 58 forecasters surveyed by Bloomberg. That's well above the 5.6% average of the past 20 years.

17.2%

Percentage of the U.S. workforce out of a job or underemployed in November

Data: Labor Dept.

Economists have blamed Europe's miasma a quarter century ago on several factors: monetary policies that were too tight; unemployed workers disinclined to search for new jobs; and companies that shied away from hiring new employees in response to government policies. On all three fronts, there's an echo of similar problems in the U.S. today.

European policymakers in the 1980s were, in the words of Johns Hopkins University professor Laurence M. Ball, "anti-inflation zealots" who kept interest rates high even after price pressures had ebbed, strangling the economy in the process. For them, "inflation is like a vampire," he says. "You can't just kill it once."

No one would accuse Fed Chairman Ben Bernanke of being a member of that obsessive crowd. Yet there are limits to what even the leader of the world's most powerful central bank can do to revive a moribund jobs market through conventional monetary policy. The short-term interest rate the Fed controls is already at 0% and can't be cut further.

The Fed chief has tried to compensate by launching programs to spur credit more directly, including the purchase of $1.75 trillion of Treasury debt, housing agency bonds, and mortgage-backed securities. But even Bernanke's fans admit they're not sure what impact those steps have had.

For Italian economists Tito Boeri and Pietro Garibaldi, the root cause of eurosclerosis was microeconomic, not macroeconomic. They say unemployment stayed high because labor mobility was limited. So after European nations reduced jobless benefits and made it easier for companies to hire and fire workers, mobility rose and unemployment fell in the mid-1990s.

But in the U.S., labor mobility is falling, not rising. As measured by the U.S. Census Bureau, it slumped in 2008 to its lowest level since records began in 1948 and likely fell further in 2009.

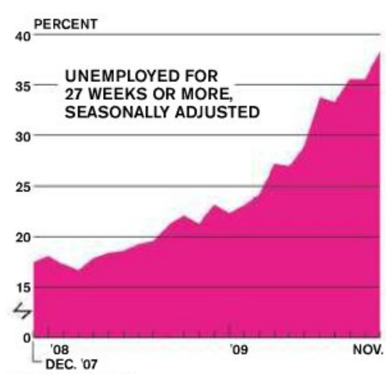
It's not cushy unemployment benefits that are encouraging the jobless to stay put. It's the 30% plunge in house prices that has left one in four homeowners with mortgages owing more than their houses are worth. That raises the ante for people looking to pull up stakes in search of a job.

What's worse, there may be no place to move because the devastation from the Great Recession has been so widespread. Unemployment has risen in all 50 states, the District of Columbia, and Puerto Rico. States that once had been job-growth engines, like California and Florida, are among the hardest hit.

Unlike Europe in the 1980s, it's not the government-imposed cost of firing workers that's keeping companies from expanding payrolls. It's more the uncertain cost of hiring them as President Barack Obama presses plans to reform health care and stem global warming through new mandates on business.

Perhaps the most disturbing parallel between 1980s Europe and the U.S. today is the rise in long-term joblessness (chart). The longer people are out of work, the harder it is for them to find a job and the more embedded unemployment becomes, making it more likely an American sclerosis could set in. | BW |

SWELLING RANKS OF THE LONG-TERM UNEMPLOYED



Data: Labor Dept.

CHRIS USHER

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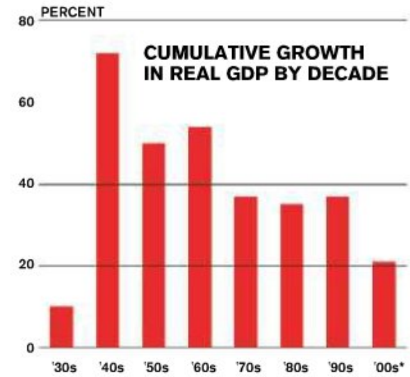
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NUMBERS

Slow Growth: The increase in U.S. GDP over the last decade is the lowest since the Depression.



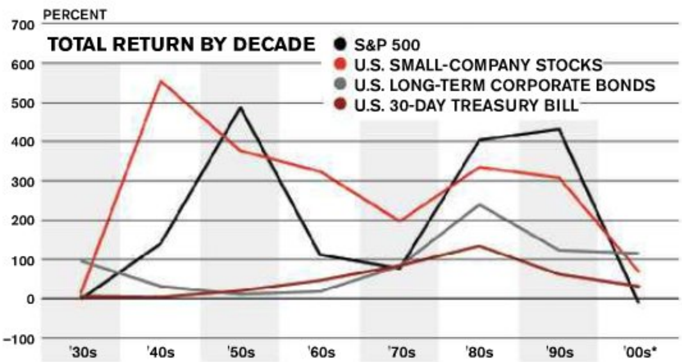
Data: Bureau of Economic Analysis *Through Q3 2009

SURVEYING A DISMAL DECADE FOR THE U.S. ECONOMY

By Tara Kalwarski/Charts by David Foster

The total return on the S&P 500 from the end of 1999 through Dec. 14, including dividends, was minus 9%. The U.S. economy is on track to have grown by less than 2% a year over the decade.

Unhappy Returns: The S&P 500 is on track to lose more in the '00s than it did in the 1930s.



Data: Ibbotson Associates *As of Nov. 30

Global Bright Spots: Energy and mining companies—along with Apple—saw the biggest jumps in market value.

COMPANIES WITH THE LARGEST MARKET CAP GAINS

	COUNTRY	MARKET CAP IN BILLIONS 12/31/1999	12/9/2009
BHP Billiton	Australia	$24.3	$204.7
Apple	U.S.	16.5	178.2
Petróleo Brasileiro	Brazil	27.6	187.4
Gazprom	Russia	5.8	129.8
Vale	Brazil	10.6	122.9

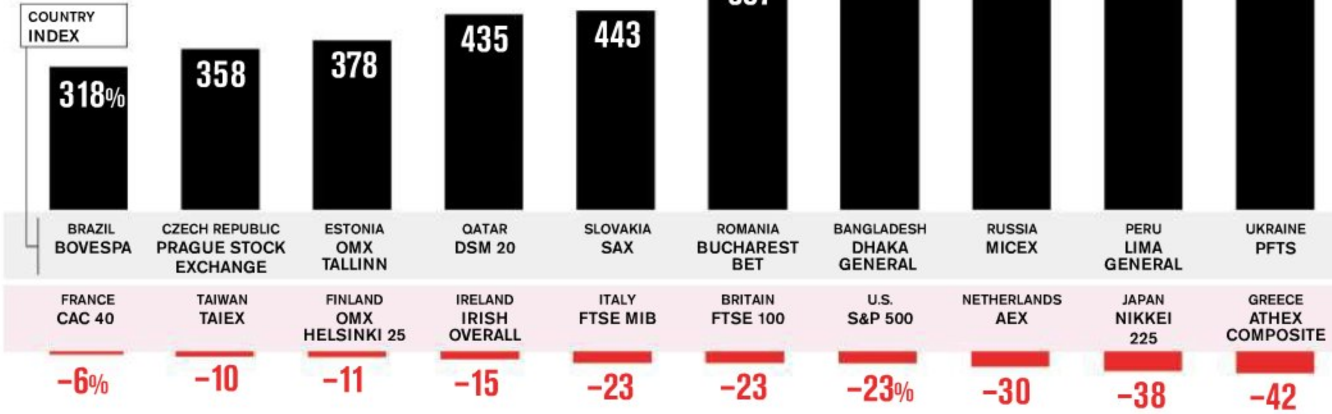
Data: Capital IQ

BOURSES THAT SOARED—AND SANK

Emerging markets boasted the decade's best performances as developed markets stumbled.

BEST- AND WORST-PERFORMING WORLD EQUITY INDEXES

PERCENTAGE CHANGE IN DOLLAR TERMS, SINCE DEC. 31, 1999*



Data: Bloomberg

*As of Dec. 14, 2009; adjusted for changes in the value of local currencies against the U.S. dollar

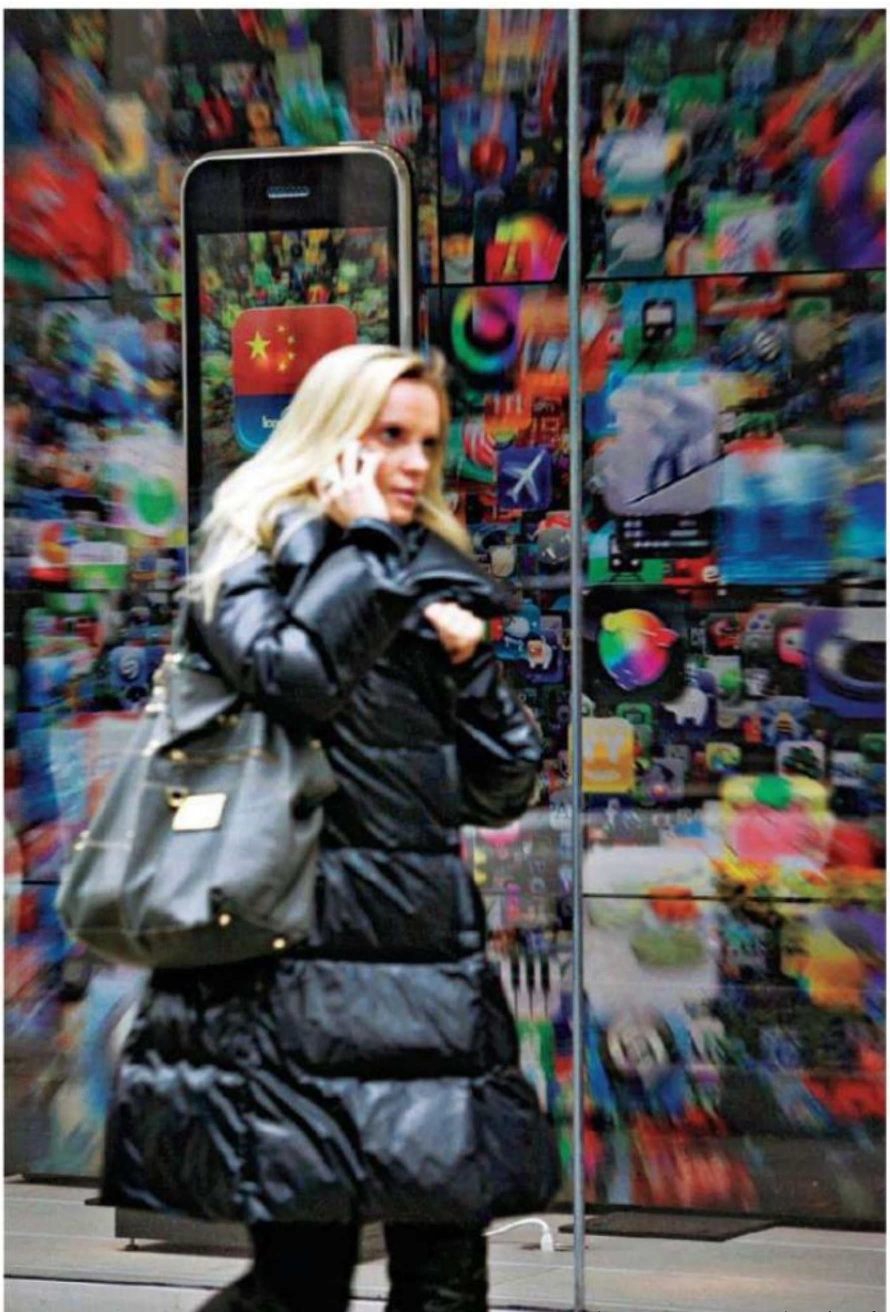
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030 The Exxon deal: Green trouble
033 Autos: Japan's B-team is hot

CAN AT&T TAME THE iHOGS?



KIICHIRO SATO / AP PHOTO

Talk of tiered pricing angers iPhone users, but there may be no other choice

By Peter Burrows and Olga Kharif

Pity poor AT&T. The wireless operator with exclusive rights to sell the iPhone in the U.S. is bashed incessantly for service that rarely lives up to the elegant promise of Apple's sleek device. Now, when many consumers feel they should be receiving rebates, the company is getting lambasted for hinting it might take measures to rein in the heaviest iPhone users. Some customers even planned to crash the company's wireless network on Dec. 18 in protest.

Yet Ma Bell, for all her shortcomings, has a point. With the smartphone fast replacing the PC as the center of many consumers' digital lives, changes in the way people use mobile computing are inevitable. Analysts and other experts say wireless operators need to train American consumers that bandwidth isn't unlimited. That won't just be good for phone companies; it'll be

Smartphone users are swamping some wireless carriers' data capacity

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good for virtually all mobile phone users. Today, AT&T says 3% of iPhone users account for 40% of the traffic on its data network. The other 97% may get better, cheaper service if YouTube video and online radio addicts paid more for the network upgrades required to support their habits. "It's not a question of if this changes, it's a question of when," says analyst Charles S. Golvin of Forrester Research.

The moment may be upon us. In an interview, AT&T Mobility President Ralph de la Vega says the carrier is mulling changes to the $30-a-month unlimited data plan that most of the company's smartphone customers use. He emphasizes that no final decisions have been made, but AT&T could institute tiered pricing models similar to today's voice plans or caps on the amount of bandwidth a consumer could use before getting bumped to a slower, cheaper network. "Carriers need to end up with a sustainable model," says de la Vega.

TRAFFIC JAMS

The old model is certainly looking dated. Verizon Wireless introduced the first unlimited wireless data plan in 2002, when most subscribers simply made voice calls and swapped e-mails on their phones. Today, iPhone users think nothing of listening to hours of online music and playing games over the Web. The difference in data use is enormous. A short video takes as much bandwidth as 500,000 text messages. In the three years since the iPhone's debut, data traffic on AT&T's network has soared 5,000%.

De la Vega is certain it's just the beginning. Tens of thousands of software developers are dreaming up applications to run on the iPhone and devices from Research In Motion, Motorola, and Nokia. Several apps already use unprecedented amounts of bandwidth: Ustream allows people (like actor Ashton Kutcher) to broadcast live video to millions of fans over the iPhone. "Other carriers are just getting a glimpse of what's coming," says de la Vega.

Many analysts think other U.S. operators are just waiting to follow AT&T's pricing lead, in part because AT&T's exclusive right to the iPhone

A GOOGLE PHONE MAY DIAL UP TROUBLE

The move into handsets could roil its Android partners

By Olga Kharif



Google has invested a lot of time and money in building a broad alliance of companies to support Android, its operating system for mobile phones. The Open Handset Alliance now totals 47 members, including hardware, software, and chip companies. Now Google is considering a move to sell its own phone, which risks undermining the coalition. Phonemakers such as Motorola and Samsung, in particular, could begin to see Google as more rival than ally if the search giant starts selling a product head-to-head with theirs. "This could destroy the Open Handset Alliance," says program manager Will Stofega of market researcher IDC.

Google hasn't confirmed it plans to sell its own phone. The company, in a Dec. 12 blog post, only says it has given employees "a device that combines innovative hardware from a partner with software that runs on Android to experiment with new mobile features and capabilities." Still, partners suspect Google will launch a phone next year. It could sell the device directly to customers, but *Bloomberg BusinessWeek* has learned that Google is also in talks about distribution with T-Mobile USA.

Google may need to sell its own smartphone to better compete with Apple, which has an early lead with the popular iPhone. To ensure its place in the emerging world of mobile computing, Google has to have a large number of people using Android phones and a broad community of developers to come up with applications. Frank Meehan, chief executive of INQ Mobile, a British company that plans to release an Android phone next year, says a Google phone could benefit the whole market. "If this helps consumers appreciate Android devices, then it's a good thing for us when we launch," he says.

But Meehan and other partners also have concerns. If Google keeps the best new Android apps and features for its own phone, it could have an unfair edge. Michael Thompson, a senior vice-president at Android app developer Nuance, says it's "very likely" that some phonemakers will drop Android if Google gets into the handset business. Some partners may switch allegiance to Android rivals, such as Symbian, the operating system backed by Nokia, or even the declining Microsoft Windows Phone. "If you want to bring Microsoft back into the game, I can't think of a better way," says Jack Gold, principal at technology research firm J. Gold Associates.

Kevin Burden, an analyst at consultant ABI Research, says Google may believe it can best showcase Android's capabilities and thereby motivate its partners. But it should recognize the risks, too. "This is kind of playing with fire," he says.

–With Crayton Harrison

ILLUSTRATION BY MARK NERYS

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■ Foreign Direct Investment

Madrid, 21th October 2009

SPAIN RANKS SIXTH AMONG OECD COUNTRIES MOST INVESTED BY FOREIGN COMPANIES

Spain moves up two places on the Foreign Investment league table and is now the sixth biggest receiver of foreign

Advances in telecoms technology, and the de

The Madrid Region concentrated 82% of foreign direct investment into Spain during 2008

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is expected to lapse next summer. As other carriers get hit with the tsunami of data from the iPhone and other devices, they will "need to introduce tiered pricing," says Forrester's Golvin.

The approach is already widespread abroad. In Britain, Orange and O2 offer cheaper data packages for iPhone owners who stay below a monthly minimum. In Australia, Telstra offers four pricing plans. And in countries such as Canada, there are caps on monthly data usage.

There's no question that AT&T has made mistakes in managing its network. Consumer advocates point out it has relied heavily on cost savings from acquisitions to boost profits rather than innovations or reliable customer service. The company also clearly underestimated the demand for iPhones and the amount of data customers would use. In a December survey by *Consumer Reports* about wireless operators, AT&T came in dead last.

Verizon Wireless has mocked the company in TV ads for its spotty network coverage. The campaign prompted a lawsuit from AT&T, but the suit was later withdrawn after Verizon held its ground. Verizon Chief Technical Officer Anthony Melone tells *Bloomberg BusinessWeek* that his company has been investing ahead of time to handle iPhone traffic, should it ever get rights to sell the device. "We have put things in place already," he says. "We will handle it if we ever get it."

AT&T, meanwhile, is racing to improve. It's upgrading software that should double the speed at which bits move from a phone to the nearest cell tower and digging trenches to add 100,000 fiber-optic lines to connect cell towers back to the Internet. Overall, the company is expected to invest $7.5 billion in its wireless network this year, says market research firm Ovum, slightly more than Verizon. Whatever his pricing strategy turns out to be, de la Vega says the company will improve its reputation for service. He recognizes, however, that may take time. "Perceptions are a tough thing to change," he says. "We understand that." **BW**

–With Spencer Ante in New York



JEWEL SAMAD/AFP/GETTY IMAGES

PRODDING BANKS WITHOUT A STICK

Obama wants to get credit flowing faster. In a post-TARP banking world, he'll have to get creative

By Bradley Keoun

The Obama Administration didn't waste any time in getting its economic message across to Wall Street. As the last big banks scrambled to return their bailout funds in mid-December, the President summoned top Wall Street chiefs to the White House, urging them to increase lending to companies and individuals. "Now that they're back on their feet, we expect an extraordinary commitment from them to help rebuild our economy," Obama told reporters after the meeting on Dec. 14.

It will take more than a guilt trip to boost credit. With Citigroup and Wells Fargo joining JPMorgan Chase and Bank of America in repaying their rescue funds, the feds have lost a big lever for lending. Not that the Troubled Asset Relief Program proved effective in getting credit flowing again. Even when they had the federal funds, banks hunkered down in the face of losses.

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Obama meets the press after talking with top bankers on Dec. 14

Loan originations totaled just $239 billion in September, down 14% from the average of $279 billion in the previous six months, according to a Treasury survey of the 22 biggest bailout recipients. Without TARP over their heads, bank CEOs are even less likely to lend.

That's because the banks still haven't recovered. JPMorgan CEO Jamie Dimon told investors on Dec. 8 that his credit-card unit—which has posted four straight quarters of losses—may lose $1 billion a quarter through June 2010. Citigroup is sitting on $182 billion of risky assets that the bank wants to unload. And Wells Fargo has $135.2 billion of commercial real estate loans; losses in the portfolio surged by 21% from the second quarter to the third. When the U.S. did its "stress tests" in May on the 19 biggest banks, the Fed estimated the group's total losses through 2010 might reach $600 billion. So far only 20% has been recognized, according to U.K. bank Barclays.

With loans losses looming, banks are squirreling away money. BofA, Citigroup, and Wells Fargo have raised or plan to raise at least $50 billion of capital. Citigroup's cash has doubled over the past year to $244 billion, according to regulatory filings. Richard X. Bove of Rochdale Securities says this is the largest stockpile he's seen at any bank in his 44 years as an industry analyst.

Regulators are encouraging the cautious stance. The post-TARP capital levels may become the new norm for big banks, says Ernie Patrikis, a former Federal Reserve Bank of New York general counsel who's now a partner at law firm White & Case in New York. Citigroup said in a Dec. 14 press release that capital by one measure would stand at 11% of assets after repaying TARP and selling stock. Under international banking rules, a well-capitalized bank is supposed to have a cushion of 6% of assets. "If the President wants the banks to start lending more, he might spend less time yammering at CEOs and more time talking to his own regulators," said hedge fund manager Tom Brown in an article on his financial research Web site, Bankstocks.com. Regulators "now seem to be insisting banks maintain minimum capital standards meaningfully above the published, official [levels]."

"These guys are in it to make money," says White & Case's Patrikis. "Who wants to be the first banker to make a bad loan?"

THE BIG PULLBACK

As capital rises, lending is falling. New York-based JPMorgan cut the unused portion of customers' credit-card lines by 6.3% this year, to $584.2 billion, as of Sept. 30, according to regulatory filings. It reduced home-equity lines by 32%, to $64.8 billion. Bank lending to businesses declined 17%, to $1.35 trillion over the past year, according to the Federal Reserve. "These guys are in it to make money," says White & Case's Patrikis. "Who wants to be the first banker to make a bad loan?"

The Federal Dilemma

Here's why it will be difficult for the Obama Administration to get banks to boost lending:

Toxic Assets Banks' books are still filled with troubled loans. Citi CEO Vikram Pandit wants to offload some $182 billion in risky assets.

Capital Needs Regulators are pushing banks to maintain a big cushion to protect against losses, money they might otherwise use to make fresh loans.

Limited Power With the big banks paying back TARP funds, the U.S. doesn't have the same leverage to influence strategy.

Data: *Bloomberg BusinessWeek*

With the big banks exiting TARP, the U.S. will have to find new ways to exert pressure. One method may be to raise the Fed funds rate, what banks charge each other for borrowing funds overnight, says Allan H. Meltzer, a Fed historian and professor at Carnegie Mellon University in Pittsburgh. Banks make money by borrowing from the central bank and investing it in higher-yielding loans and securities. With the rate hovering near zero, banks can make a nice profit simply by holding Treasuries. By upping the rate, banks would be forced to shift the money into loans. Right now "you can make three percentage points, which is a lot for a bank, for doing nothing," Meltzer says. "Why should the banks take risks?"

The government may to have rely on Fannie Mae and Freddie Mac to spur home lending. The mortgage industry is expected to make $1.6 trillion of new home loans in 2010, down from $1.9 trillion in 2009, estimates Bose George at Keefe Bruyette & Woods. The mortgage giants, which were seized by the feds 16 months ago, would seem an odd choice for federal lending efforts; the two companies have lost a combined $71 billion this year. But their influence on the mortgage market is so important that Treasury is considering an increase of their backup financing, now $400 billion, say people familiar with the situation.

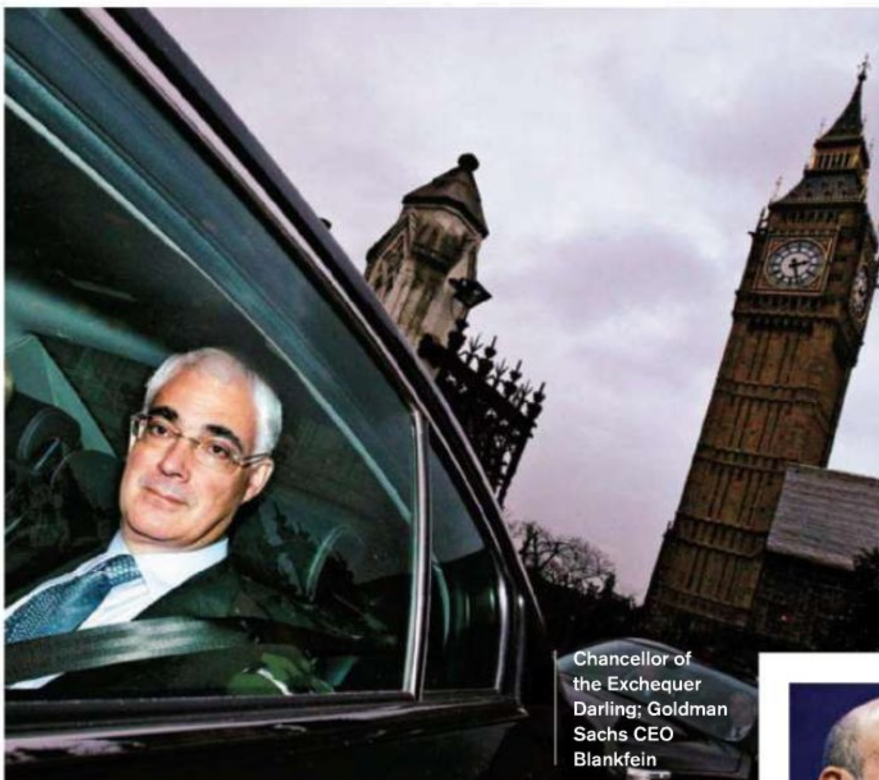
If the banks don't open up their wallets soon, the Administration could decide to lower underwriting standards for loans sold to Fannie and Freddie, says George of Keefe Bruyette. "There's no question that if [Fannie and Freddie] loosen their standards we'd have far more loans being produced. The only provider of credit is the government." |BW|

—With Elizabeth Hester in New York and Dawn Kopecki, Nicholas Johnston, and Roger Runningen in Washington

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THE 'FAT CATS' TRY TO LOOK SLIMMER

The backlash over big bonuses has Goldman, for one, making changes. But they're mostly cosmetic





Chancellor of the Exchequer Darling; Goldman Sachs CEO Blankfein

(L TO R) PHOTOGRAPHS BY LUKE MACGREGOR/REUTERS; JIN LEE/BLOOMBERG

By Ian Katz and Christine Harper

December has been tough for the global banking elite. First Britain's Chancellor of the Exchequer, Alistair Darling, slapped a 50% tax on bonuses paid to bankers. Then, days later, President Barack Obama chided "fat-cat bankers" on national television in the U.S. On Dec. 14, Wall Street began cranking up its PR machine to contain the damage, sending U.S. Bancorp CEO Richard Davis—a lesser-known, lesser-paid member of its ranks—to address reporters in Washington. America's top bankers, he said, "agreed very much" with the President "on the principles of executive compensation," adding that they "are looking forward to you seeing the good efforts we've taken in the last couple of months."

But a close look at Goldman Sachs' recent maneuvers shows that some of the changes in pay practices on Wall Street are more stylistic than substantive. Goldman, the target of so much animus in recent months, has led Wall Street's charge to get back in Main Street's good graces; on Dec. 10 the firm announced it would pay its top 30 executives annual bonuses solely in restricted stock that can't be sold for five years.

Moves like these should take off some of the heat. Because Goldman is using more stock and forcing its people to hold it for years, it's aligning employees' interests more closely with the firm's long-term health. The plan "incentivizes behavior that is in the public's and our shareholders' best interests," CEO Lloyd Blankfein said in a statement on Dec. 10.

RAISING THE HEAD COUNT

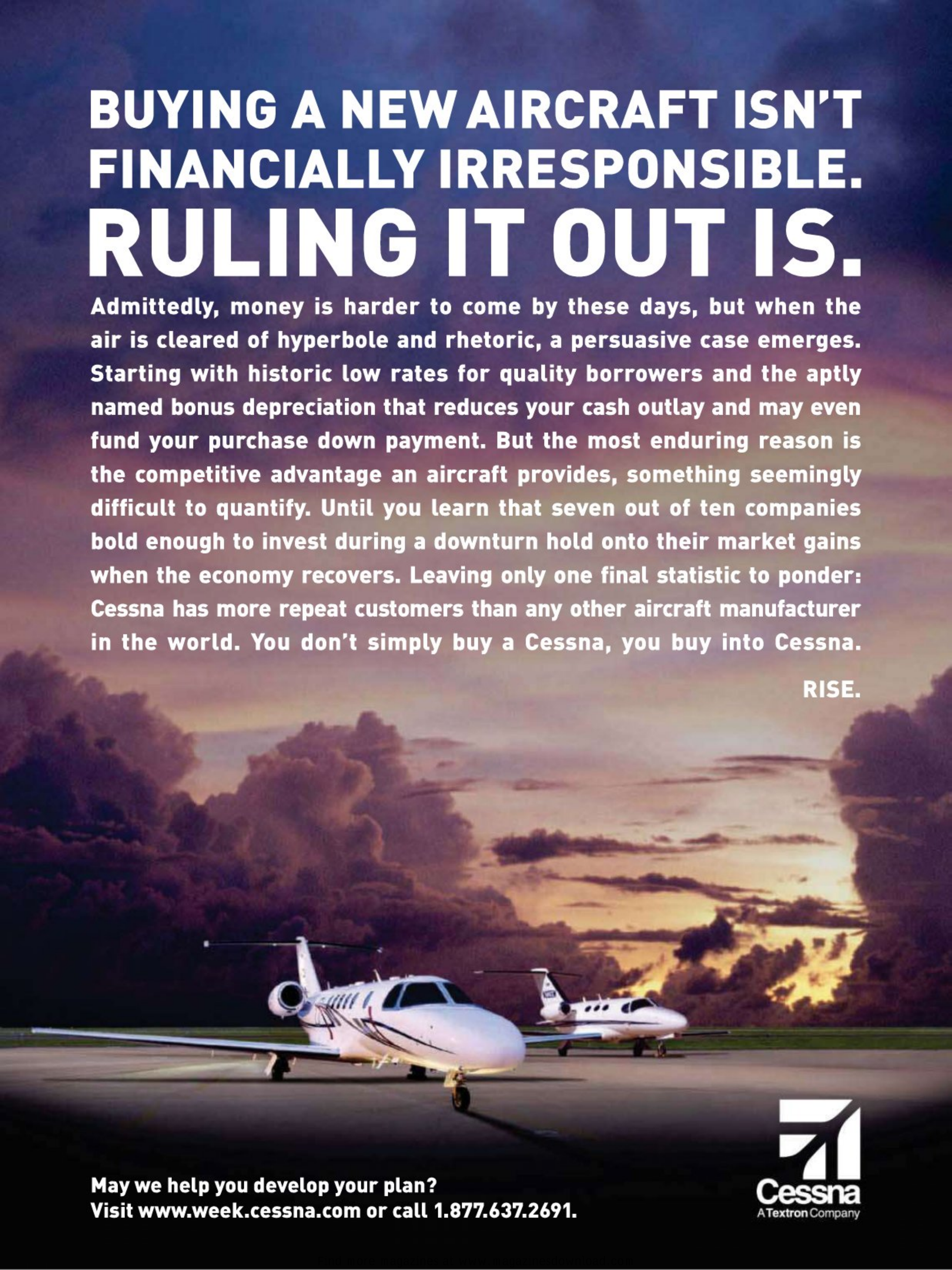
But the changes aren't likely to inflict much pain on the banks—or their employees. Goldman's awards will consist of so-called shares-at-risk. Some of those shares won't vest right away, and Goldman won't have to account for the 2009 compensation expense on its books until they do. That means it can effectively boost its profits now while lowering its compensation tab, a number that politicians will be scrutinizing. "That's just what they needed to make this year look better," says Robert Willens, a former managing director at Lehman Brothers and founder of Robert Willens LLC, a consultancy that advises investors on accounting and tax rules.

Of course, the bankers will be getting stock that could, in theory, lose all its value, as any former Lehman Brothers employee can attest. Then again, the shares could rise. Even a modest 20% increase over five years' time would add $2 million to a $10 million stock grant.

Another Goldman pay measure might alter perception more than reality. In July the company said it had begun to include consultants and temporary staff among its total head count, which has risen from 27,898 in March to 31,700 by the end of September. That should help Goldman slash its pay per employee significantly. "We match our reported head count as closely as possible to our reported compensation and benefit expense," says Goldman spokesman Samuel Robinson.

Taken together, Goldman's changes are mostly "cosmetic," says Mark Borges, compensation consultant at Compensia Inc. in Corte Madera, Calif. "This is largely being done... to show that their program is more in line with what the government is saying." |BW|

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BUYING A NEW AIRCRAFT ISN'T FINANCIALLY IRRESPONSIBLE.
RULING IT OUT IS.
Admittedly, money is harder to come by these days, but when the air is cleared of hyperbole and rhetoric, a persuasive case emerges. Starting with historic low rates for quality borrowers and the aptly named bonus depreciation that reduces your cash outlay and may even fund your purchase down payment. But the most enduring reason is the competitive advantage an aircraft provides, something seemingly difficult to quantify. Until you learn that seven out of ten companies bold enough to invest during a downturn hold onto their market gains when the economy recovers. Leaving only one final statistic to ponder: Cessna has more repeat customers than any other aircraft manufacturer in the world. You don't simply buy a Cessna, you buy into Cessna.
RISE.
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Cessna
A Textron Company



Frank unsuccessfully fought against the exemption for car dealers

CAR DEALERS COULD GET A PASS

They may be exempt from the stricter credit regs hitting the finance industries—to consumer advocates' dismay

By Jessica Silver-Greenberg

The collapse of the American auto industry has shut down thousands of car dealers across the U.S. and left many others struggling to survive. Now some that remain are trying to transform their woes into a political advantage.

Lobbyists for car dealers have won a potentially valuable exemption from major consumer protection legislation recently approved by the House of Representatives and heading for the Senate. The bill would create a new federal agency to shield individuals from ambiguous and misleading financial deals offered by home lenders, credit-card companies, and other businesses. Notably left off the list are auto dealers. That's no small loophole. Consumers hold $850 billion in car debt; dealers helped market 80% of that amount, and most collected fees for their services.

Holding salesmen to tougher standards would risk putting more of them out of business, the industry's trade group, the National Automobile Dealers Assn., has warned lawmakers. "In light of the current credit crisis and the lowest auto sales in a generation, a dramatic restructuring of auto finance would increase consumer costs, depress auto sales, and lessen competition," the association's spokesman, David F. Hyatt, says in a written statement to *Bloomberg Business-Week*. He adds that "effective federal and state laws governing dealer-assisted financing already exist."

Representative John Campbell (R-Calif.), who ran a Saab dealership before joining Congress in 2005, has helped engineer the protection of the industry. "The point here is that auto dealers are not financial entities, so why should they be regulated like one?" he says.

Dealers argue that they shouldn't fall under the jurisdiction of the new Consumer Financial Protection Agency because they generally don't provide the money for loans. Instead, car retailers act as middlemen, connecting buyers with lenders. Banks and finance companies that fund auto loans would be covered by the agency.

Consumer advocates counter that dealers play a critical role in pushing

CHRIS BUCK/CORBIS OUTLINE

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car loans—one similar to the function of mortgage brokers in the real estate market. Mortgage brokers would be covered under the version of the regulatory reform legislation that the House approved on Dec. 11. The bill's chief sponsor, Financial Services Committee Chairman Barney Frank (D-Mass.), unsuccessfully opposed the auto dealer exemption.

Car salesmen can direct customers to lenders offering higher interest rates than might be available elsewhere and sometimes encourage loans that are unnecessarily large, the Cambridge Winter Center for Financial Institutions Policy, a liberal think tank in New York, said in a report last month. "Far from being passive administrators with respect to auto finance, auto dealers actively market and price borrowers' loans," the center asserted.

Exempting auto dealers would be particularly inappropriate now because car salesmen are being hit with fresh complaints that they are preying on financially unsophisticated members of the military services, consumer activists say. In November, Michael S. Archer, a civilian regional legal assistance officer with the Marine Corps at Camp Lejeune, N.C., wrote a five-page memo outlining a series of instances in which he says local dealers took advantage of men and women in uniform.

The memo, which Archer sent to a number of consumer groups, mentioned situations where North Carolina dealers allegedly falsified customers' credit information, concealed high interest rates, or pressured troops into purchasing expensive cars with large loans that they couldn't afford on military pay. Archer concluded: "The majority of service members who have been ripped off in motor vehicle sales will probably never see a military legal assistance attorney.... Some may not even know they have been ripped off." |BW|

$850 billion

The size of the U.S. auto loan market

Data: Cambridge Winter Center for Financial Institutions Policy

BEN FRANKLIN, WHERE ARE YOU?

Hurt by smaller R&D budgets and offshoring, America falls behind in the global patent race

By Michael Arndt

Has the U.S. lost its Yankee ingenuity? For the first time in 2009, non-Americans were granted more U.S. patents than resident inventors, accounting for 50.7% of new grants, according to recent data from the Patent & Trademark Office. Moreover, for only the second time in the last 25 years, patent applications fell overall in the year ended Sept. 30.

The role reversal had been only a matter of time. Led by Japan and the likes of South Korea and China, other countries have been zigzagging their way higher in patent awards for decades, while the number granted to U.S. residents peaked in 2001. Still, the inflection point troubles American tech industry advocates and other analysts. "The U.S. is losing its innovation base," says Robert D. Atkinson, founder and president of the Information Technology & Innovation Foundation (ITIF), a Washington think tank.

The shift reflects in part moves by U.S.-based companies to offshore research and development. Take IBM, a company that for 16 years running has ranked No. 1 in patent volume. Big Blue still owns the rights to an invention that originated in one of its Indian labs, but the Patent Office would include it in its foreign resident tally. Taxes are one reason more innovation is going abroad. The U.S. once boasted the most generous research and development tax credits among the 30 countries in the Organization for Economic Cooperation & Development. Now, according to the ITIF, it ranks 17th, as other nations have cut taxes to spur investments in labs and equipment.

U.S. education gets rapped, too. India and China produce more scientists and engineers than the U.S., and international students who attend American universities generally must return home as soon as they've graduated. "We're forcing these people to do their productive work elsewhere," says Mark Chandler, general counsel of Cisco Systems. "They should have a green card stapled to their admittance letter."

PATENT RACE

Americans fell behind in U.S. patents for the first time in 2009



*Fiscal year ended Sept. 30.
Data: U.S. Patent & Trademark Office

The 2.3% drop in overall patent applications is likely a byproduct of the Great Recession, as companies slash R&D budgets to help maintain profits. The last decline was in 1996, when new global rules on the duration of patent protection went into effect, prompting applicants to hustle and file in 1995. The only other time over the past three decades that the number of patent seekers fell was in 1983, when the U.S. was emerging from a deep recession.

As before, the slide in applications will likely last just a year. But 2008 could turn out to be the last time the U.S. won the patent race. |BW|

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A Chesapeake Energy rig for drilling through shale in Texas

EXXON BUYS A GREEN HEADACHE

Its $31 billion deal for a shale gas company could bring on a chorus of disapproval from environmentalists

By Steve LeVine

With its deal to buy XTO Energy for $31 billion, ExxonMobil became the first major oil company to bet serious money on shale gas, a type of natural gas found trapped in hard subterranean rock. With Exxon's move to scoop up a top independent producer, say analysts, other majors will lock in their own supplies of shale gas, which the industry promotes as a clean, abundant fuel.

Yet the ire of environmental and consumer groups could threaten the future of shale gas. A debate is raging on the harmful effects of its production through a process called hydraulic fracturing. No definitive answers have emerged. But investors are already noticing. Says Edward Morse, an analyst with brokerage LCM Commodities: "I think the green guys cannot be underestimated."

Exxon itself is aware of the risks it's running. Under terms of its XTO acquisition, the deal would be invalidated if Congress outlaws hydraulic fracturing or makes it "commercially impracticable." Neither Exxon nor XTO would comment on the terms. Already, Chesapeake Energy has decided not to drill in the watershed that supplies New York City's drinking water. "From Chesapeake's standpoint, the chances of getting permits in any reasonable time period were small," says Lee O. Fuller, vice-president for government relations for the Independent Petroleum Association of America. Chesapeake says it would have developed the watershed safely.

The Environmental Protection Agency is studying the effects of hydraulic fracturing, and on Dec. 14, Representative Edward J. Markey (D-Mass.) said he would hold hearings early next year on both the market impact of the Exxon acquisition and environmental complaints about hydraulic fracturing.

Shale gas is located far beneath the surface in deposits throughout the U.S. To get at it, drillers blast a pressurized mix of water, chemicals, and sand into the rock to create fractures so gas can be brought to the surface.

Activists want proof that the drilling doesn't pollute groundwater. Abigail Dillen, a New York-based lawyer with Earthjustice, a nonprofit law firm, says shale gas drilling in Pennsylvania has yielded "enormous spikes in dissolved solids and sulfates," pollutants that are strictly regulated by Washington. The industry's Fuller says energy companies' production of wastewater complies with the Clean Water Act.

To lobby Congress, in March a group of independent gas producers, including XTO, launched America's Natural Gas Alliance. John H. Pinkerton, CEO of Range Resources, labels the environmental attacks "alarmist and wrong." He figures the problems of shale gas are minuscule compared with other energy sources. "It's unfathomable to me why we are talking about hydraulic fracturing." Until the talking stops, doubts about shale gas production will remain. |BW|

THE BIG PRODUCERS

Independents lead in shale gas development

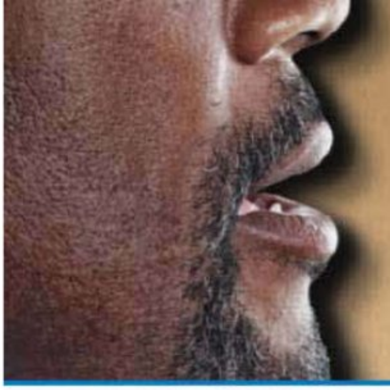
COMPANY	PROVEN RESERVES (billions of barrels*)
Anadarko Petroleum	2.3
Chesapeake Energy	2.1
Devon Energy	2.4
Range Resources	0.45

*Oil equivalent

Data: Company reports

ROBERT NICKELSBERG/GETTY IMAGES

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“I thought at my age there was nothing I could do about it, then I had ‘the talk’ with my doctor.”

Your Doctor Talks to Men About ED Every Day

Your doctor will tell you that there is something you can do about your erectile dysfunction (ED). In fact, millions of men over 40 have already taken the first step and talked to their doctor about ED. And so can you.



Doctor portrayal.



Need Some Ideas on How to Open Up to Your Doctor?

The hardest part about having ‘the talk’ is getting those first few words out. Here are some ideas to help you break the ice when your doctor asks how everything's going:

The Direct Approach:
“I have trouble sometimes in bed. Could it be ED?”

The Indirect Approach:
“Is it true age affects sexual performance?”

The Silent Approach:
Just hand this ad to your doctor, he'll take it from there.

Running the Numbers

Did you know half of all guys over 40 have some form of ED? Here are some numbers to keep in mind from a recent survey of men with ED:



of men were anxious about talking to their doctor about ED.



of men felt relieved after talking to their doctor.



Tell Me More

To learn more about VIAGRA for the treatment of ED, and ED in general, visit **viagra.com** today. You'll find an online sexual health quiz, videos of guys with ED who've had the VIAGRA Talk and other helpful information.

Over 20 million men have already had their VIAGRA Talk. Isn't it time you had yours?

Important Safety Information

We know that no medicine is for everyone. Don't take VIAGRA if you take nitrates, often prescribed for chest pain, as this may cause a sudden unsafe drop in blood pressure.

Talk with your doctor first. Make sure your heart is healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, seek medical help right away.

In the rare event of an erection lasting more than four hours, seek immediate medical help to avoid long-term injury.

In rare instances, men who take PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision, or sudden decrease or loss of hearing. It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience any of these symptoms, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time.

VIAGRA does not protect against sexually transmitted diseases including HIV.

Please see Important Facts for VIAGRA on the following page or visit viagra.com for full prescribing information.

For free information, including questions to ask your doctor, call 1-888-4VIAGRA (1-888-484-2472).

VIAGRA®
(sildenafil citrate) tablets

You are encouraged to report negative side effects of prescription drugs to the FDA. Visit www.FDA.gov/medwatch or call 1-800-FDA-1088.

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IMPORTANT FACTS

VIAGRA® *(sildenafil citrate)* tablets (vi-AG-rah)

IMPORTANT SAFETY INFORMATION ABOUT VIAGRA

Never take VIAGRA if you take any medicines with nitrates. This includes nitroglycerin. Your blood pressure could drop quickly. It could fall to an unsafe or life-threatening level.

ABOUT ERECTILE DYSFUNCTION (ED)

Erectile dysfunction means a man cannot get or keep an erection. Health problems, injury, or side effects of drugs may cause ED. The cause may not be known.

ABOUT VIAGRA

VIAGRA is used to treat ED in men. When you want to have sex, VIAGRA can help you get and keep an erection when you are sexually excited. You cannot get an erection just by taking the pill. Only your doctor can prescribe VIAGRA.

VIAGRA does not cure ED.

VIAGRA does not protect you or your partner from STDs (sexually transmitted diseases) or HIV. You will need to use a condom.

VIAGRA is not a hormone or an aphrodisiac.

WHO IS VIAGRA FOR?

Who should take VIAGRA?

Men who have ED and whose heart is healthy enough for sex.

Who should NOT take VIAGRA?

- If you ever take medicines with nitrates:
  - Medicines that treat chest pain (angina), such as nitroglycerin or isosorbide mononitrate or dinitrate
- If you use some street drugs, such as "poppers" (amyl nitrate or nitrite)
- If you are allergic to anything in the VIAGRA tablet.

BEFORE YOU START VIAGRA

Tell your doctor if you have or ever had:

- Heart attack, abnormal heartbeats, or stroke
- Heart problems, such as heart failure, chest pain, or aortic valve narrowing
- Low or high blood pressure
- Severe vision loss
- An eye condition called retinitis pigmentosa
- Kidney or liver problems
- Blood problems, such as sickle cell anemia or leukemia
- A deformed penis, Peyronie's disease, or an erection that lasted more than 4 hours
- Stomach ulcers or any kind of bleeding problems

Tell your doctor about all your medicines. Include over-the-counter medicines, vitamins, and herbal products. Tell your doctor if you take or use:

- Medicines called alpha-blockers to treat high blood pressure or prostate problems. Your blood pressure could suddenly get too low. You could get dizzy or faint. Your doctor may start you on a lower dose of VIAGRA.
- Medicines called protease inhibitors for HIV. Your doctor may prescribe a 25 mg dose. Your doctor may limit VIAGRA to 25 mg in a 48-hour period.
- Other methods to cause erections. These include pills, injections, implants, or pumps.

POSSIBLE SIDE EFFECTS OF VIAGRA

Side effects are mostly mild to moderate. They usually go away after a few hours. Some of these are more likely to happen with higher doses.

The most common side effects are:

- Headache
- Feeling flushed
- Upset stomach

Less common side effects are:

- Trouble telling blue and green apart or seeing a blue tinge on things
- Eyes being more sensitive to light
- Blurred vision

Rarely, a small number of men taking VIAGRA have reported these serious events:

- Having an erection that lasts more than 4 hours. If the erection is not treated right away, long-term loss of potency could occur.
- Sudden decrease or loss of sight in one or both eyes. We do not know if these events are caused by VIAGRA and medicines like it or caused by other factors. They may be caused by conditions like high blood pressure or diabetes. If you have sudden vision changes, stop using VIAGRA and all medicines like it. Call your doctor right away.
- Sudden decrease or loss of hearing. We do not know if these events are caused by VIAGRA and medicines like it or caused by other factors. If you have sudden hearing changes, stop using VIAGRA and all medicines like it. Call your doctor right away.
- Heart attack, stroke, irregular heartbeats, and death. We do not know whether these events are caused by VIAGRA or caused by other factors. Most of these happened in men who already had heart problems.

If you have any of these problems, stop VIAGRA. Call your doctor right away.

HOW TO TAKE VIAGRA

Do:

- Take VIAGRA only the way your doctor tells you. VIAGRA comes in 25 mg, 50 mg, and 100 mg tablets. Your doctor will tell you how much to take.
- If you are over 65 or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg).
- Take VIAGRA about 1 hour before you want to have sex. VIAGRA starts to work in about 30 minutes when you are sexually excited. VIAGRA lasts up to 4 hours.

Don't:

- Do not take VIAGRA more than once a day.
- Do not take more VIAGRA than your doctor tells you. If you think you need more VIAGRA, talk with your doctor.
- Do not start or stop any other medicines before checking with your doctor.

NEED MORE INFORMATION?

- This is only a summary of important information. Ask your doctor or pharmacist for complete product information OR
- Go to **www.viagra.com or call (888) 4-VIAGRA (484-2472).**

Uninsured? Need help paying for Pfizer medicine? Pfizer has programs that can help. Call **1-866-706-2400** or visit www.PfizerHelpfulAnswers.com.

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AUTOS: WHY JAPAN'S B-TEAM IS HOT

Deals are up as Western rivals covet the technology and sales networks of Suzuki, Mitsubishi, and Mazda

By Ian Rowley and Makiko Kitamura

TOKYO



This has been a tough year for Japan's automakers. Hobbled by the supercharged yen and weak global sales, most top manufacturers have lost money. Domestic sales, meanwhile, are off by 12%, the sixth straight year of contraction. Now Japan has suddenly become the epicenter of auto-industry dealmaking.

On Dec. 9, Volkswagen said it will spend $2.5 billion for 19.9% of Suzuki. Six days earlier, PSA Peugeot Citroën said it was looking into a partnership with Mitsubishi Motors. Many pundits think Mazda Motor could also be in play given that its longtime partner, Ford, has cut its stake to 11%, from 34%. Mazda says it hasn't made any decision on alliances.

The industry's real growth is likely to come from Asia's emerging giants, China and India. But Japan's second-tier players all have valuable production and research knowhow that is attractive to potential buyers. Unlike the Japanese, says Andrew Phillips, an analyst at KBC Securities in Tokyo, "a lot of Chinese companies are still at the stage where they are copying things."

While skeptics fret that Peugeot may overpay for Mitsubishi, the Japanese company has substantial expertise in electric vehicles; this year it became the first major automaker to introduce an electric car—its i-MiEV. Successful new Ford models such as the Fiesta, Focus, and Fusion were developed jointly with Mazda. And its factories, which can build many different-size models on a single production line, are among the most flexible in the industry.

The Japanese second string also comes with sales networks that could complement larger partners' weaknesses. Mazda has 859 dealers in North America and more than 2,300 in Europe. Mitsubishi, which makes the zippy Lancer EVO, has 400 U.S. dealerships and a loyal following among sports car buffs. And it would take years for Volkswagen to match Suzuki's 50% market share in India, where the German company has sold just 16,000 cars this year. "The point of partnering with Suzuki is to grab India," says Koji Endo, an analyst at Advanced Research Japan.

Few Chinese and Indian carmakers want or need strategic partners. Most of China's big state-owned automakers already have joint ventures with foreigners, and investors have bid up prices of private companies. "In the current environment, it is more likely that Indian and Chinese companies would buy Western companies than the other way round," says Ashvin Chotai, managing director of consultancy Automotive Intelligence Asia.

Both buyers and sellers should be wary, given that a previous round of dealmaking mostly foundered. General Motors in 2005 and 2006 sold stakes in Isuzu, Suzuki, and Subaru's parent, and Daimler sold its 34% stake in Mitsubishi in 2005. But don't expect that to dissuade acquisitive auto chiefs. "Alliances are at the top of the agenda," said Volkswagen Chief Executive Martin Winterhorn in Tokyo on Dec 9. "And they are indispensable for competition." |BW|



Mazda's flexible production lines can produce many different models at once

TOMOHIRO OHSUMI/BLOOMBERG NEWS

SECOND-TIER AUTOMAKERS IN PLAY

SUZUKI
VW is spending $2.5 billion for a 19.9% stake, eyeing Suzuki's small-car knowhow and strong sales in India

MITSUBISHI
It's discussing an alliance with Peugeot that could give the French company Mitsubishi's electric-car technology

MAZDA
With partner Ford in retreat, Mazda is attractive due to strong U.S. and European sales and efficient factories

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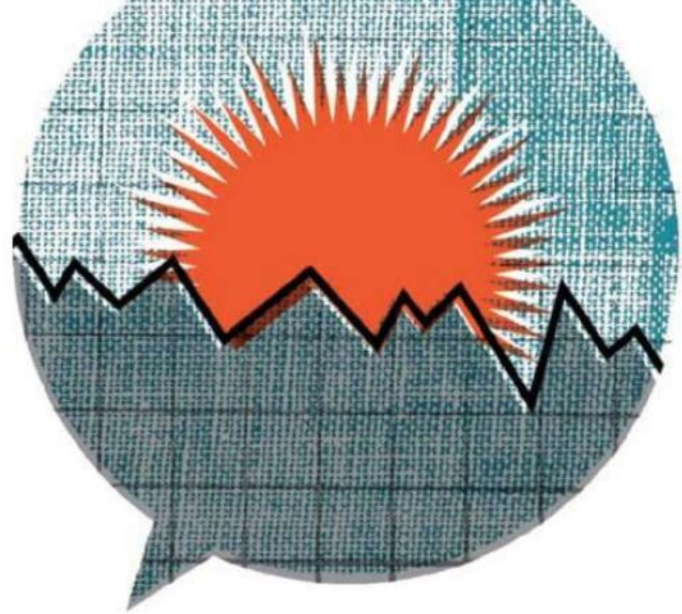
Bernie Madoff channeled Charles Ponzi. In 2009 he went to prison

JIN LEE/BLOOMBERG NEWS

2009 The Year of Living Furiously

Before you flip to our cover package on the Investment Outlook for 2010 (page 45), spare a few minutes for 2009. Was it a good year or a bad year? In the next pages, we'll weigh the evidence. On the good side, the Standard & Poor's 500-stock index rose almost 23% through mid-December, and the Nasdaq gained nearly 40%. On the bad side, the U.S. unemployment rate hit a quarter-century high, the federal budget deficit grew to its biggest share of the economy since 1945, and the anger toward Wall Street, personified in the extreme by the villainous Bernie Madoff, clouded reason. It was a year of ups (gold and foreclosures) and downs (Tiger Woods and the U.S. dollar). General Motors and Chrysler entered bankruptcy court but quickly got out. Billionaire Warren Buffett claimed that his purchase of Burlington Northern was an "all-in bet on the economic future of the United States," but then, what kind of future? The railroad hauls coal, lumber, and agricultural products—not exactly cutting-edge. Oh, well. At least the U.S. is in better shape than Greece, the new sick man of Europe. Turn the page, dear reader, and relive 12 months you're not likely to forget. |BW|

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By Peter Coy

SMILE. AT LEAST IT ISN'T A SECOND DEPRESSION

Anger over bailouts could thwart a sustainable recovery

A woman is watching her grandson at the shore when a huge wave washes him out to sea. She beseeches God for help, and sure enough, the next wave deposits the boy back where he was, unharmed. The woman looks up and says: "Thank you, Lord. But he had a hat."

That old joke about ingratitude is especially apt as America dwells relentlessly on economic problems and the financial crisis. Things are bad, all right, especially if you're out of work or about to lose your home. But in this holiday season, as we count our blessings, please recall that the situation could have been much, much worse. One year ago there was serious talk about a downturn rivaling that of the 1930s. "Let's not mince words," *New York Times* columnist Paul Krugman wrote on Jan. 5, 2009. "This looks an awful lot like the beginning of a second Great Depression."

Someone or something deserves thanks for the surprising fact that the economy seems to be growing again; banks that took bailout money are repaying the government sooner than expected; and the unemployment rate actually fell a couple ticks in November—albeit to a still-miserable 10%. If you're not religious, feel free to thank the resilience of the American people. Or the virtues of free-market capitalism. Or even—dare I say this?—the timely interventions in 2008 and 2009 of the White House, Congress, and the Federal Reserve.

True, the government did a lot of things wrong, but it also did a lot right. President George W. Bush's Treasury Secretary, Henry Paulson, pushed for an unpopular Troubled Asset Relief Program that helped stabilize the financial system. The Fed under Chairman Ben Bernanke slashed short-term rates to near zero and invented new ways to lend that kept credit flowing to essential functions when normal channels were clogged. As households and businesses madly cut spending, President Barack Obama filled the gap in demand by pushing through Congress a $787 billion stimulus package.

All these things more or less did what they were supposed to—they tided over the economy until the natural forces of economic regeneration could begin to kick in. That's no small feat. Columbia University economist Frederic Mishkin, a former Fed governor (and therefore not impartial), estimates that this financial crisis was actually more serious than the one that turned into the Great Depression.

You don't hear much about the bright side on talk radio or in Congress. Second-guessers are jumping all over the government's rescue of American International Group last year. With the benefit of hindsight, they criticize the Federal Reserve Bank of New York for its rushed decision to pay AIG's counterparties 100 cents on the dollar to terminate derivative contracts. They say the New York Fed should have paid them less, which would have saved taxpayers money. The Fed "refused to use its considerable leverage," Neil M. Barofsky, the TARP special inspector general, wrote in a November audit.

Well, maybe. But in the chaos that prevailed last September and October, the Fed and the Treasury worried that putting too much pressure on AIG's counterparties might deepen the global financial crisis by heightening fears that important players wouldn't make good on their obligations. At this late date, lecturing the crisis fighters about having wasted money is like reprimanding ambushed CONTINUED ON PAGE 038

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By Paul M. Barrett

A CRISIS IS A TERRIBLE THING TO WASTE

This should have been the year of radical financial reform

In 2009 we wasted a perfectly good financial crisis.

With disastrous economic events accumulating in March, President Barack Obama exhorted listeners during a weekly radio talk to "discover great opportunity in the midst of great crisis." It's an appealing conceit: seeking breakthrough achievement in a time of danger.

That's why it's such a shame we didn't take advantage of the Wall Street crisis of 2008 by making 2009 the Year of Real Financial Reform.

Instead, the Obama Administration offered half-measures. The financiers lobbied against even modest reforms, and a Congress drenched in Wall Street campaign cash has peppered proposed regulation with loopholes. At a conference in the U.K. on Dec. 8, Paul A. Volcker, the former chairman of the Federal Reserve and an Obama adviser, addressed an audience of bankers and executives who were insisting that Wall Street and big corporations can police themselves, without more government scrutiny. "Wake up, gentlemen," Volcker said, according to media reports. "Your response is inadequate."

The warning applies to regulators and politicians as well. The crisis of 2008 offered a once-in-a-lifetime opening to overhaul the U.S. financial engine. It's a machine that can do much good by raising and allotting capital and much damage when allowed to run unchecked. Now, as stock markets recover and bank earnings bounce back, mass amnesia has set in. Political momentum has waned. Financial reform legislation is getting weaker by the week. And Goldman Sachs Chief Executive Lloyd C. Blankfein says we should be grateful to investment bankers for "doing God's work."

The most fundamental failure has been the Administration's unwillingness to take seriously the murmurings of that shrewd old giant, Mr. Volcker, who wants to reverse course on bank gigantism. In the 1990s, Wall Street convinced both political parties that combining all manner of financial services into unfathomable Goliaths was necessary in a global economy. Poof went the safeguards instituted in the wake of the Great Depression separating the public-utility-like functions of the financial system—customer deposits, conventional commercial loans, and so on—and the casino of investment banking and high-stakes trading. The consolidation accelerated a race for hugeness that gave us institutions that are "too big to fail": basket cases like Citigroup and risk factories like American International Group and Goldman. Without hundreds of billions of taxpayer rescue dollars flooding the markets, all of these firms, and many more, might have collapsed, bringing on *Great Depression—The Sequel*.

With popular skepticism toward Wall Street at a peak in early 2009, our political and business leaders did ... nowhere near enough. The White House bought the Wall Street line that bigger is better, or at least unavoidable. Now the banks are larger and more intricate than ever. As *The Wall Street Journal* noted recently, the world's 10 biggest banks account for about 70% of global banking assets, up from 59% three years ago.

Maybe we'll eventually see new requirements for larger capital cushions at individual banks to absorb future losses. Maybe we'll see the establishment CONTINUED ON PAGE 038

ILLUSTRATIONS BY OLIVER MUNDAY

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CONTINUED FROM PAGE 036

soldiers for firing too many bullets. The real problem was not the response to the crisis, but the years of missteps and neglect that caused it. Congress is working now on ways to better regulate such complex financial institutions, plus a new mechanism to shut them down smoothly without having to pay off their creditors in full at taxpayer expense.

Anger over the cost and unfairness of this financial crisis is understandable and can even be salutary if it drives people to root out wrongdoing and close loopholes. However, anger that sprays out in a thousand directions is dangerous. Undiscriminating rage clouds judgment, invites tea-party grandstanding, and prevents the kind of deliberative give-and-take that will be required to make sure this mess doesn't happen again.

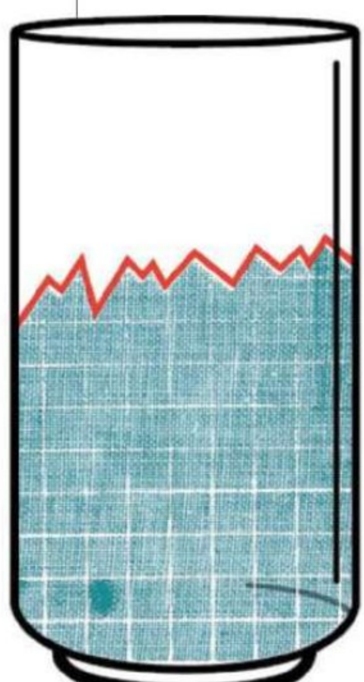
Japan provides a tragicomic tale of the damage that can occur when the public gets angry and the government takes the easy way out. (Keep in mind that Japan's main stock market gauge is still down 74% from its level of 20 years ago, so whatever Japan did, we should try to do the opposite.)

A bit of history: When Japan's real estate bubble burst in the 1990s, ordinary citizens opposed taxpayer bailouts for the specialized housing lenders that had helped inflate the bubble. But after promising not to use public funds, the Finance Ministry eventually pumped in a bit of money in 1995. It was only about $7 billion. Still, the public was so outraged that the opposition party nearly managed to topple the government.

That $7 billion brouhaha precipitated a bigger problem in 1997, when Japan's crisis deepened and big commercial banks and securities firms started failing. Frightened of the voters' reaction, the government did not ask for enough money to recapitalize the financial sector. It resorted to accounting dodges and brave declarations that the problem was solved. It wasn't, of course. The failure to fix the banking system prolonged Japan's slump for years.

Cynicism and rage could put the U.S. in the same hole, warns Anil Kashyap, an economist at the University of Chicago's Booth School of Business who recounted the cautionary tale from Japan in a December 2008 paper with Takeo Hoshi of the University of California at San Diego. Fearful, Congress has deflected blame onto the Fed and other agencies. Ultimately, though, preventing the next crisis will require building those agencies up, not tearing them down. Also, many economists argue that the economy could slip back into recession or torpor without more fiscal stimulus and more asset purchases by the Fed. Yet Congress and the central bank are wary of a public that has come to equate almost any government action with taxpayer ripoffs.

Dispiriting, isn't it? On the bright side, we've already made a lot of progress. All we need now is the civic courage to keep doing the right things. |BW|



CONTINUED FROM PAGE 037

of a new bank-subsidized rescue fund to cover the costs of potential failures. We could even get greater regulatory authority to block certain bank mergers. But the too-big-to-fail mammoths are still just that. The implicit taxpayer safety net—now explicit—means that some bankers almost certainly will engage in the kind of risk-taking that brought us the subprime fiasco. Why not? Someone else will clean up the mess.

The tame alternative to real regulation is greater transparency. And, yes, we will have more disclosure of credit-derivatives trading. These are the insurance policies against bond defaults that helped tempt Wall Street to ratchet risk up to unprecedented levels. But with derivatives, as with bank heft, the politicians have bought what Wall Street is selling.

Lawmakers backed away from any serious attempt to slow the invention of novel exotic trades whose side effects few, if any, really understand. My colleagues at Bloomberg News have lately reported that some of the very same geniuses who brought us toxic credit-default swaps are now angling to juice the carbon-trading market with climate-change derivatives. If the pilfered e-mails from squirrelly British scientists weren't enough to cast doubt on the campaign against global warming, greenhouse-gas swaps surely will do the trick.

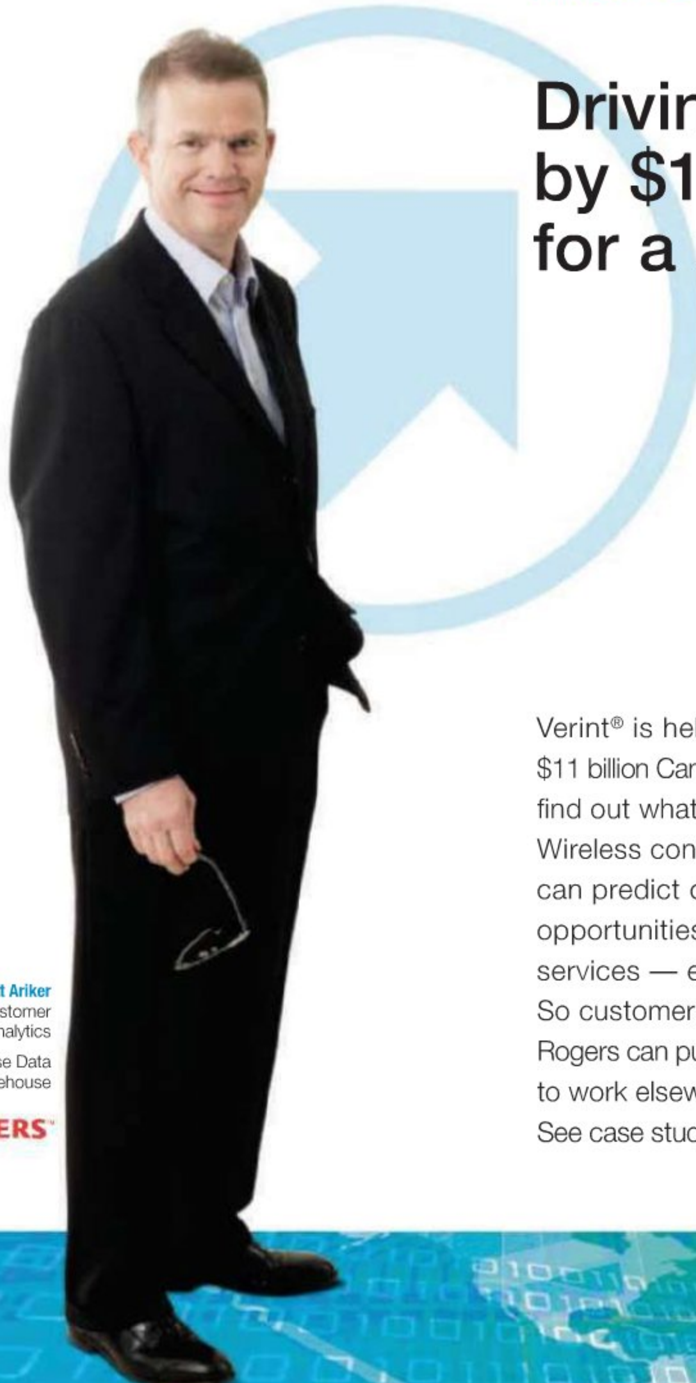
The list of missed opportunities is too long for one humane sitting. I'll wrap up with lawmakers' mishandling of the credit-rating scandal. Moody's, Standard & Poor's, and Fitch played a major role in the crisis by rubber-stamping their triple-A approval on mountains of mortgage-backed bonds that went bad. These companies enjoy their lucrative oligopoly only because of a publicly sanctioned system requiring mutual funds and money managers to buy securities given high ratings by the Big Three. But there's a rank conflict of interest: The issuers of bonds pay the credit agencies to rate the bonds. Why we take the ratings seriously remains one of the great mysteries of the financial world.

Congress roughed up some rating-agency executives at hearings and may yet require more disclosure here, too. But the basic conflict persists. Genuine reform fizzled. We'll regret it when the next crisis hits. |BW|

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Matt Ariker
VP, Customer Management & Analytics
VP, Enterprise Data Warehouse
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THANK GOODNESS THAT'S OVER

By Robin Paul Ajello

The unbelievable quotes, acts, and ideas of 2009

IRONY'S NOT DEAD, BUT IT NEEDS REGULATION

In a 6,900-word *Times* of London profile, Goldman Sachs CEO Lloyd Blankfein quips that he's "doing God's work." This was apparently intended as a joke, but it seems no one likes a funny banker in a recession.

AN 'F' IN HISTORY

After a government bailout, AIG announces outsize bonuses for employees of its financial products unit—the very same unit that helped precipitate the global financial meltdown. Hauled before a hostile Congress in March, then-CEO Edward Liddy backtracks.

ANYTHING TO SAVE HOWARD STERN'S JOB

Media tycoon John Malone rescues satellite radio company Sirius XM with $530 million in loans that eventually give him a 40% stake. Sirius avoids almost certain bankruptcy.

THRIFT GOES UPSCALE

With American consumers in lockdown, the media (including this magazine) dusts off the word "frugal." Acting frugal becomes almost as trendy as being, well, a spendthrift.

ONE MAN'S TRASH...

Wilbur Ross Jr. makes the most of the dog days of 2009—gobbling up gold, cheap mortgages, and a chunk of a Chinese electric utility. He also makes a mint on muni bonds.

NOT READY FOR PRIME TIME

Treasury Secretary Tim Geithner muffs his first major appearance before Congress, speaking with frustrating vagueness about the Administration's stimulus plans. Geithner eventually improves at playing a Cabinet Secretary on TV.

THE PRODUCT LAUNCH THAT DIDN'T

Palm unveils its handsome Pre smartphone, a decided improvement on its predecessors. It gets lost in the shadow of Apple's iPhone. Dud runner-up: Barnes & Noble's Nook, a not-as-good-as-Kindle e-reader.

BUFFETT'S BIG BET

Warren Buffett's Berkshire Hathaway buys Burlington Northern Sante Fe railroad for $34 billion. The move buoys markets and helps spur faith in America's future.

ILLUSTRATIONS BY LOU BEACH; ILLUSTRATIONS BASED ON PHOTOS: ARNELL AND BLANKFEIN BY JEMAL COUNTESS/GETTY IMAGES; HENDERSON BY BILL PUGLIANO/GETTY IMAGES; BUFFETT BY ANDREW HARRER/BLOOMBERG NEWS

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LIMITED WARRANTY

Within weeks of inheriting the thankless job of leading General Motors into Chapter 11, CEO Fritz Henderson begins taking fire from his new boss, Chairman Ed Whitacre. By late November, Henderson is history.

ACROSS THE WORLD, ANOTHER PALM PROBLEM

With no warning, Dubai's Sheik Mohammed bin Rashid al Maktoum announces that state-owned Dubai World will delay repaying billions in debt. Markets gyrate, and faith in his sandy city-state is shaken.

THE NEW TRANSPARENCY

"People say 'Oh, but people standing may get killed if there's a crash.' Well, with respect, the people sitting down might get killed as well."—Ryanair Chief Michael O'Leary on his plan to replace some of his airline's seats with handrails.

VENTI BRANDING PROBLEM

Trying to win back its indie cred, Starbucks opens two Seattle stores that don't use its name or logo. The two tea-and-coffee stores host poetry readings and serve wine and beer.

BECAUSE PARENTS HAVE NOTHING ELSE TO WORRY ABOUT

Maclaren, the British baby stroller maker, recalls 1 million prams in the U.S. because 12 tots had fingers amputated by the folding mechanism. Worst recall runner-up: Toyota, for a gas pedal in multiple models that sticks and propels cars forward without warning.

IMAGINE IF THE JAPANESE RAN GM

Toyota CEO Akio Toyoda, channeling management guru Jim Collins' theory of corporate decline, says his company is a step away from "capitulation to irrelevance or death."

THE O.J. TRIAL

PepsiCo hires advertising guru Peter Arnell to overhaul Tropicana's branding. The rethink is so jarring, shoppers can't find their orange juice. PepsiCo is forced to bring back the old packaging.

—With Susan Berfield, Nanette Byrnes, Kerry Capell, Peter Coy, Cliff Edwards, Burt Helm, Tom Lowry, Carol Matlack, Stanley Reed, Ian Rowley, and David Welch

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MANY HAPPIER RETURNS



A rhymed retrospective by Marc Miller
Illustrations by Michael Witte

2009? No valentine—
The landscape looks like *District 9*,
Though corporate corpses line the lawns
Instead of otherworldly prawns.
Among the living, those once strong
Now huff and puff and wheeze along,
Unless, of course, they got a gift
When stimulus gave them a lift.
So many deemed too big to fail
And so few deemed too big to bail,
The situation gives one pause—
Who made **Tim Geithner** Santa Claus?
With federal spending out of sight,
Paul Krugman says it's still too slight.
The controversy's fierce, but wait,
There's still the health-care-bill debate.
The public option's blown a fuse,
The Senate bill will lose, win, lose,
They'll never make Olympia Snowe see
Eye to eye with **Ms. Pelosi**,
Lieberman says no, yes, no,
While Harry Reid—oh, let it go.
A back-and-forth on cap-and-trade
Means going green's again delayed,
And how can joy be unalloyed
With double-digit unemployed
And upward-sailing federal debt...
Did I say Merry Christmas yet?





Well, Merry Christmas anyhow,
And first of all, the deepest bow
To those whose companies survived,
And in some cases even thrived:
At Goldman Sachs, somehow **Lloyd Blankfein**
Kept the profits of his bank fine;
Richard Anderson impressed
With Delta's merger with Northwest,
While Citi's **Pandit** spread some cheer
By working for a buck a year,
As did the chief of Oracle—
What, Ellison? Historical!
Bob Iger helped make Disney shine
By snapping up the Marvel line
And also made his stock price spark
Announcing that new Shanghai park,
While Microsoft made big noise revvin'
Up to market Windows 7.
Signs of life were found, they say,
By analysts of M&A,
And Jeffrey Bewkes at last was able
To unwind Time Warner's cable.
Wal-Mart bravely soldiered on
In price wars vs. Amazon,
But happiest of all, perhaps,
Was anyone who markets apps,
From recipes for turkey scraps
To farts to Chinese take-out maps.
Such downloads, though they may be pap, 'll
Surely warm the hearts at Apple.



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Season's greetings, too, to those
Whose bottom lines hit thudding lows,
Or who are never coming back:
An R.I.P. for Pontiac,
And even Saturn fell to earth
(I liked the Vue, for what it's worth),
Though GM, in a bid to cope, 'll
Sell, keep, sell, keep, sell, keep Opel.
Massive debt at AMR,
Six Flags and Saks are under par,
And for the umpty-umth year, Boeing
Can't get its Dreamliner going.
NBC is finding ten o'
Clock is not prime time for **Leno**.
(Will its programs be more trendy
Once it's cut off from Vivendi?)
Intel's having not much fun
In being sued by everyone,
While **Rupert Murdoch** feels the sting
Of Google (his solution: Bing).
The woe extends to **Donald Trump**,
Who's suffering from a gambling slump,
And layoffs even ruled the day
(And this is rare) at J&J.
Some not-too-prudent marketing
Meant sales were down at Burger King,
And though their image is aglitter,
Are they in the black at Twitter?
Little changed at CIT:
It's barely out of bankruptcy,
While profits were a constant lack
At Fannie Mae and Freddie Mac.
Oh, one more thing that made us freak:
When Bloomberg purchased *BusinessWeek*.

So for next year, here's what I'm thinking:
Let the trade gap go on shrinking,
Let each market force allow
A solidly five-digit Dow.
In fact, let every market fly—
The DAX, the Nikkei, heck, Dubai.
Let the feds still run GM,
But once it's healthy, fire them.
More electric cars, and please,
More cost-efficient batteries.
Let the media brass divine
A way to make a buck online,
And let that buck not plunge so low
The U.S. ends up with no dough.
Let a sluggish SEC
Resolve its **Madoff** misery,
And let the BLS report
Statistics of a happier sort,
With millions of well-paid new jobs,
For everyone, not just Lou Dobbs.
Let the housing market soar
Right back to where it was before,
And let consumer spending rise,
But don't let debt metastasize.
Peace on earth, good will toward men,
And see you in 2010.





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Going up: Shanghai, site of the World Expo, may see robust growth

2010 Investment Outlook

By Peter Coy

After a long, hard day of conquering the world, Chinese industrialists toast deals with Scotch whisky. This is an opportunity for London-based Diageo, the world's largest distiller. In 2007 it introduced Johnnie Walker Blue Label George V Edition at $600 per crystal decanter. Sales in Asia were so strong that Diageo topped itself this year with The John Walker at a suggested retail price of $3,000. It's "performing very well," the company says.

Investors looking ahead to 2010 can learn from Diageo. Figure out where wealth is being produced in the world and grab a piece of it, whether that's in China or Brazil or the U.S. Don't count on a robust economic recovery to lift the stocks of run-of-the-mill companies, because most economists expect a weakish rebound.

We predicted in this space one year ago, when blood was running in the streets, that investors would "do well by buying what's out of favor," such as high-yield bonds. Did they ever: Through November in the global markets, junk bonds returned 58%, followed by commodities (36%), gold (34%), stocks (29%), and investment-grade corporate bonds (23%). Bring-

REUTERS/CHINA DAILY

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ing up the rear in returns was the safe choice, government debt (8%). But the easy money from amping up risk is over. Now it's time to choose safer plays in stocks, bonds, and commodities that will thrive even as the U.S. economy continues its struggle to get back to good health.

In that light, going global is a good, sensible theme for 2010. It's one of the few things that passive and active investors can agree on, even though they have opposite reasons. Passive investors believe that you can't beat the market, so they favor a little-bit-of-everything approach to reduce the risk from any one investment going bad. By their philosophy, the maximum diversification comes from spreading your bets all over the globe, not just in your home country. Ideally, the passive investing camp says, Americans' investment in U.S. stocks should be no higher than U.S. stocks' share of global market capitalization. That share has fallen from 70% in 1970 to 48% in 2009, according to MSCI Barra, which calculates market indexes.



Caddy shopping in China: Luxury brands are selling well overseas

IMAGINECHINA VIA AP IMAGES

You can even argue that Americans should underweight U.S. stocks to offset their heavy exposure to the U.S. through the homes they own on American soil. Not many Americans are that internationally diversified. A typical 401(k) in the U.S. has about five times as much invested in U.S. stocks as in foreign stocks, according to a survey by Hewitt Associates.

Active investors are also exploring investments abroad, but not just for diversification. In contrast to index-fund investors, they believe you can beat the market—and many happen to think that some of the best bargains for 2010 lie outside the U.S., in markets that have been less picked over by professionals. An investor who miraculously managed to select the top 10 stocks in the world in each market sector each year for the eight years through December 2008 would have had a cumulative return of almost 7,000%, says MFS Investment Management, the Boston-based fund manager. In contrast, MFS adds, an equally foresighted investor who was restricted to the top-performing stocks in the Standard & Poor's 500-stock index would have had a cumulative return of just under 1,500%. In other words, if you have any faith in your stockpicking, you will want to roam the world for candidates.

Whatever their motivation, many Americans are likely to intensify their search for investments abroad in the coming year. An online investors' survey for *Bloomberg BusinessWeek* in early December found that 40% of American investors plan to increase their exposure to international stocks over the next five years, up from 22% a year ago. The survey included 770 Americans as well as 158 international investors who had been recruited to participate in periodic online polls by Bloomberg BusinessWeek Research Services. Some things don't change quickly, though: Asked which stock market would produce the best returns over the next year, Americans were still more likely to pick the U.S. than any other country. Among foreign investors surveyed, the U.S. came in fourth after China, India, and Brazil.

Those non-U.S. investors may be on to something. In comparison with the outlook in the recuperating U.S., prospects for growth are much stronger in Asia and in resource-rich nations such as Brazil, Canada, and Australia, where business confidence recently reached its highest level in seven years. "The U.S. economy, with all due respect, is not such a dominant part of the global economy as it used to be. We're going to have decoupling" of other countries from the U.S. in terms of economic performance, says Oded Shenkar, a professor at Ohio State University's Fisher College of Business. The case for going global is even stronger if you believe that the dollar will sink in 2010. Returns on foreign stocks and bonds are worth more to Americans when the dollar falls against other currencies. The Federal Reserve has vowed to keep short-term interest rates extremely low until the U.S. economy gains strength, which may not be until summer or later. Low U.S. rates put downward pressure on the currency.

Buying multinationals is an easy way to bet on global growth without mucking about in names you've never heard of. Not just any multination-

WHAT'S INSIDE

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America In 2010

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The Risks Ahead

074 WHAT TO WORRY ABOUT NOW Investors must learn to embrace the dollar's new volatility.

078 THE CASE FOR COMMODITIES They could be a smart inflation hedge in 2010. And some pros see a long-term bull market.

082 HEDGE YOUR BETS LIKE THE BIG BOYS More private equity and hedge-fund-like investments are being aimed at retail investors. Is that a good thing?

084 HITS AND MISSES IN 2009 The advice we gave investors last year was on the money—with some exceptions.

al will do, though. Makers of consumer staples that serve the growing markets of Asia and Latin America are a good bet for 2010, says Rajiv Jain, head of international equities for Vontobel Asset Management in New York. Diageo is one, of course. Others include Coca-Cola, Nestlé, McDonald's, and BAT (if owning a tobacco company doesn't bother you). Many of these companies have handsome dividend yields as well as price-earnings multiples that are historically low in comparison with those of growth stocks, Jain says.

If you want even more exposure to growth in the developing world, try a company like Nestlé India—not a multinational, of course—which has had 11 consecutive quarters of strong revenue growth. "If you look at their numbers, you would never know there was a recession," says Jain.

In contrast, this is not the best year to go all-in on an industrial renaissance. There is still massive overcapacity in manufacturing in the U.S. despite plant shutdowns and layoffs. China made its own excess of productive capacity worse when it staved off an economic slump by building plants, equipment, infrastructure, and housing.

The tech sector should do somewhat better than general manufacturing because it enjoys shorter product cycles: If customers have any money at all, they tend to replace their computers and communications gear when the stuff becomes obsolete. Worldwide semiconductor sales rebounded more than 50% from their February 2009 lows through October, notes economist Edward Yardeni of Yardeni Research in Great Neck, N.Y. But tech stocks have risen a lot from their nadirs, so they're no great bargains at current prices.

Banks and other financial companies don't look like good deals, either. They continue to be weighed down by weak loans and investments that were made during the go-go years. And the off-balance-sheet financing they once used to juice up their returns is now pretty much off limits, says Wasif Latif, an equity portfolio manager and a member of the asset allocation team of USAA, the San Antonio-based financial-services firm for the armed forces and veterans. Plus, financial stocks have risen a lot from their priced-for-Armageddon lows.

It's been a crazy year. Somewhere out there is a hapless investor who stayed fully invested all through the crash, then finally capitulated and sold in early March, only to watch from the sidelines in horror as the Standard & Poor's 500 rebounded 65% through mid-December. To make sure that's not you in 2010, think hard about your investment choices so you can have the courage of your convictions. Make an investing plan and stick to it, advises Eileen Rominger, chief investment officer of Goldman Sachs Asset Management in New York, which oversees about $850 billion of investments. "You need a solid foundation of knowing what you own and why you own it," Rominger says. "In this volatile environment, the temptation for investors to do the wrong thing at exactly the wrong point in time is tremendous."

That's especially good advice if you're venturing for the first time into unfamiliar territory such as foreign stocks and bonds. It's a big world, with lots of opportunities. Don't let the strangeness frighten you away. | BW |

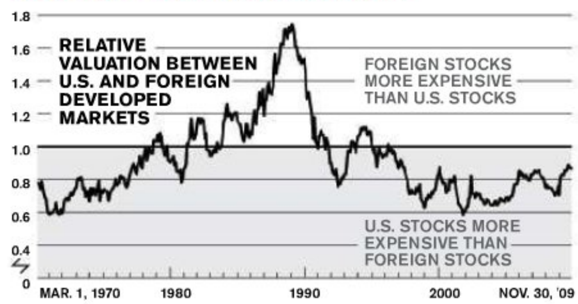
Americans Mostly Invest At Home...

PERCENTAGE OF ALL 401(K) ASSETS, YEAREND 2008



Data: Hewitt Associates survey of 120 large-plan sponsors

...But Foreign Valuations Remain Attractive...



Data: Citigroup, MSCI Barra, MFS Investment Management

...And Emerging Markets Are Growing Fast

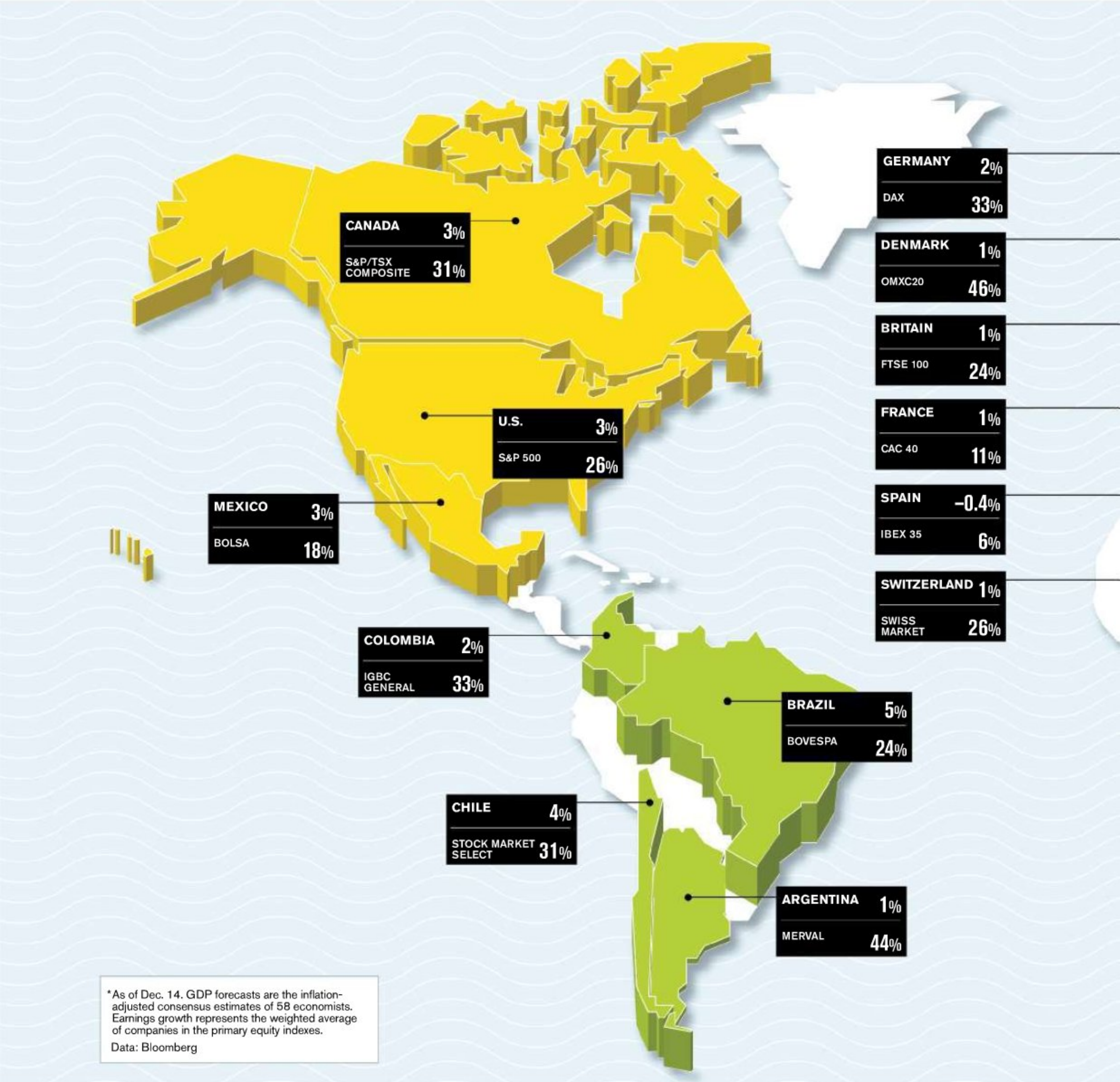
EMERGING MARKETS' SHARE OF GLOBAL ECONOMIC OUTPUT



Data: Ned Davis Research, Haver Analytics

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WHERE THE GROWTH IS

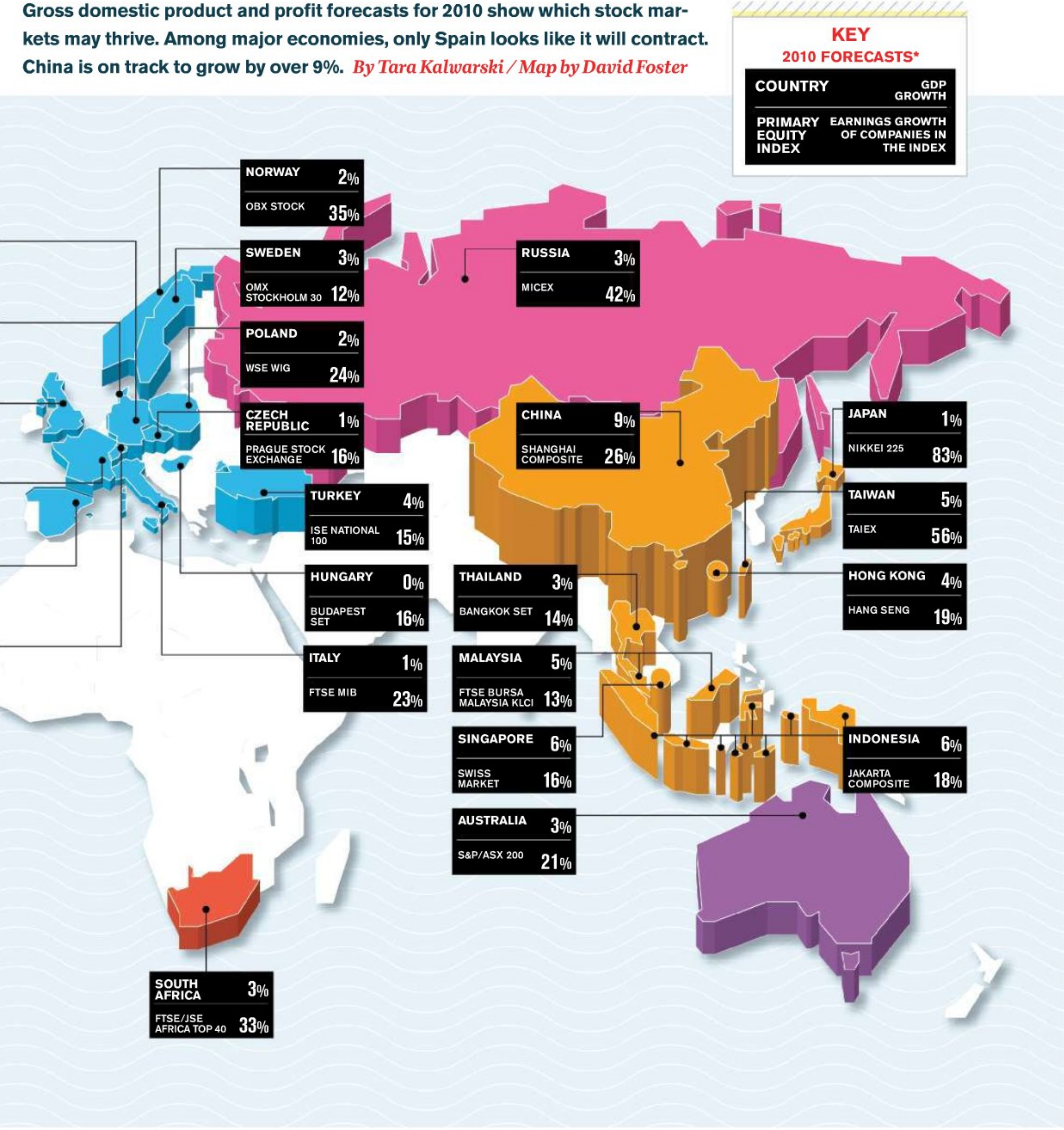


*As of Dec. 14. GDP forecasts are the inflation-adjusted consensus estimates of 58 economists. Earnings growth represents the weighted average of companies in the primary equity indexes.

Data: Bloomberg

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Gross domestic product and profit forecasts for 2010 show which stock markets may thrive. Among major economies, only Spain looks like it will contract. China is on track to grow by over 9%. *By Tara Kalwarski / Map by David Foster*



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America in 2010

SUNNY, WITH A CHANCE OF RELAPSE

BY RICH MILLER

AT THE VERY LEAST, 2009 created a rare sense of unanimity among economists. With the country in its worst recession since the 1930s, and unemployment at a 26-year high, economists of all stripes agreed: the economy was a disaster.

Thankfully, 2010 should be a lot less historic. That also means the outlook for the new year is a lot less unanimous. On average, the 58 economists surveyed by Bloomberg in early December expect that the U.S. economy will muddle along at the 2.6% average annual growth rate of the past 20 years, that consumer prices will rise 2.1%, and that joblessness will remain at 10% for the year.

But these are just averages, and they obscure two distinct—and extreme—views of where the U.S. economy is headed. The first camp—let's call them the history-repeats-itself crowd—sees the economy bouncing back strongly next year, growing 3.5% or more. After all, that's what happened in the mid-1970s and the 1980s as pent-up demand powered the economy forward after steep contractions. The second set of economists argues that this time, it's different. They foresee a restrained rebound as shell-shocked workers shy away from shopping and banks keep a tight rein on credit. The



PHOTOGRAPH BY DAN SAELINGER

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result, they say, is growth next year of about 2% or less in the wake of an economy that shrank by an estimated 2.5% in 2009.

If the history lovers are correct, stocks may continue to be a good place to put money. If the revisionists are right, bonds may be the market to be in. What it may come down to is a bit of both: The economy is likely to start out strongly as production ramps up from recession levels only to fade as underlying weaknesses crimp growth. That's a view shared by Mohamed El-Erian, chief executive officer of Newport Beach (Calif.)-based bond giant Pimco. "I'm more bearish than the consensus," says El-Erian. "I think we start the year at 3% [growth] and then end up at 2%."

RAPID REBOUND

The optimists pin their hopes on something called the Zarnowitz rule. Named after the late economist and business cycle theorist Victor Zarnowitz, it posits that deep recessions are usually followed by rapid rebounds. "A tremendous amount of activity was put on the back burner," says Stephen Stanley, chief economist at RBS Securities in Stamford, Conn. "We're going to have a lot of pent-up demand coming through."

Typically, companies slash stockpiles after a recession hits because they don't want to be stuck with products they can't sell. When demand starts to stabilize, they ramp production back up and rebuild inventories so as not to miss out on potential sales and profits.

That's likely to happen in spades in 2010, the history followers say. Through mid-2009, cuts in inventory acted as a drag on the economy for six out of seven quarters—the worst record since the government began keeping score in 1947.

In the third quarter, that pattern changed. Inventory cuts waned, allowing the economy to grow. Companies may soon start to rebuild stockpiles. "We're in a sweet spot with regard to inventories," says David Hensley, director of global economic coordination at JPMorgan Chase in New York.

"I'M MORE BEARISH THAN THE CONSENSUS," SAYS PIMCO'S EL-ERIAN. "I THINK WE START THE YEAR AT 3% [GROWTH] AND...END UP AT 2%."



Barclays Capital's Maki says U.S. CEOs will soon feel pressure to expand operations

It's not just inventory that companies have cut too deeply, says Dean Maki, chief U.S. economist at Barclays Capital in New York. Amid warnings from doomsayers that the U.S. was headed for another Depression, business slashed spending on factories and equipment and pared payrolls more than was justified by the contraction of the economy. Calculations based on Okun's law, which was developed by the late economist and White House aide Arthur Okun and links joblessness to output, arrive at the same conclusion—that unemployment should be lower than it is. "As the economy starts growing, it's no longer going to be acceptable for CEOs to tell shareholders, 'we survived,'" Maki says. "They're going to have to look for ways to expand their business and their sales."

Even housing will add to growth in coming quarters, according to the optimistic view. Faced with a collapse of the market, homebuilders cut back on construction so much that a mild revival of demand could turn things around. Residential construction accounted for a record low 2.5% of gross domestic product in the first nine months of 2009, below the post-World War II average of 4.7%.

The rebound in housing and the economy will stoke inflation and prompt the Federal Reserve to start raising interest rates in the middle of year, Stanley says. He sees the federal funds rate, the rate commercial banks charge each other for overnight loans, at 3% by the end of 2010, up from the Fed's current target of zero to 0.25%.

EVAN KAFKA

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Goldman Sachs' Jan Hatzius sees structural roadblocks to a robust recovery

ON THE OTHER HAND...

The pessimists brush aside talk of a housing rebound and inflationary pressures. Rather than focusing on the cyclical forces that propel recoveries, they're concentrating on structural impediments that could hold the economy back. "This business cycle is different," says Jan Hatzius, chief U.S. economist at Goldman Sachs. "The downturn was driven by the bursting of a bubble."

The collapse of home prices, down more than 25% over the past three years, has destroyed trillions of dollars in wealth and left consumers more inclined to save than spend, naysayers argue. While the savings rate rose to an average 4.5% near the end 2009, it's below the 7% average of the last 50 years, so the rate may rise. "A lot of households are being more frugal," says Nariman Behravesh, chief economist at IHS Global Insight in Lexington, Mass. "That's good for household finances but not so good for growth in the short run."

Sky-high unemployment will also act as a brake on consumer outlays. "The biggest job losses were in construction and manufacturing," says Bart van Ark, chief economist at the Conference Board. "Many of those jobs are gone forever." Permanent layoffs—layoffs of workers who don't expect to regain the same job—hit a record 55.1% of those out of work in November.

Banks are also likely to be cautious in handing out credit as they dig out from under the wreckage of the financial crisis. "What we need to do first is clean up the overhang of toxic assets that sit in zombie-like banks," says Rajeev Dhawan, director of the economic forecasting center at Georgia State University's Robinson College of Business.

The number of "problem" banks that may have to be taken over by the government climbed to 552 at the end of the third quarter to the highest level in 16 years, according to the Federal Deposit Insurance Corp. The agency also reported on Nov. 24 that the amount of bank loans outstanding fell 2.8% last quarter, the biggest drop since the FDIC started keeping records on bank loans in 1984. With bank credit tight, the Fed has little reason to lift interest rates, reason the pessimists. Hatzius expects the Fed to hold rates near zero through all of 2010 and 2011.

The economy may well start out the year with a bang. The thing to keep an eye on will be the quality and sustainability of growth. Pimco's El-Erian notes that if the economy is being powered by temporary factors, such as companies restocking shelves, investors may want to be cautious. If instead final demand is rising, with consumers and companies spending more, then happier days may indeed be here again. |BW|

MY FAVORITE INDICATOR

Michael Hartnett

Chief Global Equity Strategist, Merrill Lynch



Chinese property stocks are the global leading indicator right now. The Shanghai Composite Property Index, made up of 33 Chinese real estate and construction companies, was among the first to tank in 2007 and the first to start rallying back in November 2008.

Why do I like this indicator? Because China stimulates its economy through real estate. From a global perspective, if China is building, commodities will go up. Since these companies are sensitive to prices, they'll be among the first to detect inflation.

Currently, these stocks aren't as unambiguously positive as they were three months ago. If they start to decline, it would indicate that investors expect the Chinese to tighten monetary policy. It was the first to ease interest rates, and the most aggressive. They got it right, and their stock market was the first to start to recover. When China raises rates, that will have a ripple effect through global equity markets. *—as told to Tara Kalwarski*

PHOTOGRAPH BY EVAN KAFKA; ILLUSTRATION BY ANDY FRIEDMAN

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HOUSING HEADS OUT ON ITS OWN

The big test for home prices will come next spring when the feds start to withdraw from the market

By Prashant Gopal



Colleen Baldrica and her husband are using their tax credit on new hardwood floors

THOMAS STRAND

The U.S. housing market has been on government life support for much of 2009. Thanks to the feds' bounty of tax credits, purchases of mortgage securities, interest-rate cuts, and home loan programs, new and existing home sales are up. The median home price rose, to \$177,900. What happens in 2010 depends on whether the market can stand on its own.

The big test comes this spring. The Federal Reserve says it will stop buying mortgage-backed securities by the end of March, a program that has helped make home loans more affordable and spurred sales. The market may also suffer a setback if the central bank hikes interest rates, as some economists predict. With foreclosures expected to jump, Moody's Economy.com estimates home values will fall 7.8% in 2010.

The U.S. also plans to phase out the popular home buyer's tax credit by April. Right now first-time buyers get \$8,000 and repeat buyers \$6,500. As first-time buyers rushed to capitalize on the credit before its original yearend expiration date, purchases of existing homes surged; in October they were up 23.5% over the previous year to reach their highest levels since February 2007, according to the National Association of Realtors. Colleen and Jim Baldrica took advantage of the government gift when they purchased a three-bedroom rambler on a lake in the Minneapolis suburb of Stillwater for \$245,000 this year. The Baldricas, who are planning to use their tax savings to pay for new hardwood floors, hope the credit will make it easier for others to buy the home they've lived in for 21 years.

With the government stepping back, homeowners will have to put their faith in the economy. Whether the rebound in real estate has staying power will depend on mortgage rates remaining low and the unemployment picture improving, says Celia Chen, senior director of Moody's Economy.com: "If everything works according to script, job growth will have kicked in, and we'll be on the way to economic recovery by the middle of next year."

That doesn't mean home values are likely to surge. "Keep in mind, when you reach the end of the bust you tend to have flat prices for years," says David Stiff, chief economist at Fiserv, a research firm in Brookfield, Wis. The median home price won't turn until 2011, when it is expected to rise only 3.4%, according to estimates from Moody's.

The aggregate numbers, though, don't tell the full story about real estate, which remains highly localized. The former bubble markets, including Arizona, California, Florida, and Nevada, may remain in the doldrums long past the rest of the country. In Phoenix, some troubled borrowers got temporary modifications of their loans through a Treasury program designed to

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prevent foreclosure. But they may not qualify for permanent workouts if they don't have the paperwork to prove their income or show they occupy the home. Prices in the city could drop another 23% through 2010, according to Moody's Economy.com.

On the flip side, Texas, North Dakota, and Oklahoma, whose local economies are fueled by the energy business, will bottom out before other places. Home prices in North Dakota are expected to remain flat in 2010 while prices continue to fall in the rest of the country, estimates Moody's Economy.com. What follows is a look at four major cities that represent various factors affecting U.S. home prices in both directions. | BW |

ILLUSTRATIONS BY CHRIS PHILPOT

A Tale of Four Cities



LOS ANGELES

Prices are on the mend in Los Angeles, which has a tight supply of homes. Residential values rose 2.2% in the third quarter over the previous second quarter, according to the Standard & Poor's/Case-Shiller index. The improvement is giving sellers confidence to bump up asking prices. The owner of a one-bedroom condo increased his listing in December to $429,000, from $379,000. Still, the recovery in L.A. could hit the skids next year if unemployment there goes higher than the current 12%. The cash-strapped state government continues to lay off local workers. The city also faces a tide of foreclosures when borrowers' payments balloon on risky adjustable rate mortgages. "The recent appreciation in L.A. is temporary and will start going down toward the end of this year as the selling season ends," says John Burns, a real estate consultant.



ATLANTA

In 2009, Georgia had more bank failures than any other state, with many centered around the capital. The busted lenders provided loans to the developers that fueled the building craze. That's wreaking havoc on housing: By yearend prices are expected to be down 36% from their peak in 2006. "We still have a fair amount of pain to come in terms of bank failures and ripple effects," says Dorsey Farr, a principal at French Wolf & Farr, an Atlanta investment adviser. "I don't think we're out of the woods." The seller of a four-bedroom brick home in the upscale Buckhead neighborhood has cut the listing from $525,000 in September to $460,000.



DALLAS

Like much of Texas, Dallas has had it easy. Prices have fallen just 11%, vs. 23% for the rest of the country, and may rebound in 2010 thanks to a strong job market. The metro area is home to AT&T and semiconductor-maker Texas Instruments, which recently opened a chip plant in a suburb. "Dallas looks poised to have a reasonable degree of employment stabilization in 2010," says Jim Gaines, a research economist for the Real Estate Center at Texas A&M University. "That would firm up demand for housing even after the home-buyer credit expires."



NEW YORK

New York was one of the last real estate markets to stumble, and it's likely to be one of the last to bounce back. That's because the local economy didn't slump until 2008, after the collapse of investment bank Lehman. Now the pain has spread from the financial sector to retail, tourism, and other industries. And home values remain high, even relative to the area's inflated salaries. Prices in New York and surrounding suburbs are expected to fall another 18%. One pressure point: a flood of new listings. Developers in Manhattan are sitting on thousands of luxury condos, waiting for prices to perk up. Wall Street and its big bonuses could help ease the pain. Says Jonathan Miller, CEO of appraiser Miller Samuel: "I see the bonuses tempering the downside rather than generating a burst of activity."

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WASHINGTON SWINGS AT REFORM

In subtle but significant ways, policymakers will change the way Wall Street does business.

By Theo Francis

Before seasoned investors buy or sell, they run through a checklist of considerations. Here's an important one: New regulations. "Every time we look at an investment, we ask ourselves in what way the tentacles of U.S. or foreign government are going to interact with this investment," says Craig Perry, chairman of Sabretooth Capital Management, a $150 million hedge fund in New York.

The sweeping reforms that politicians promised after the collapse of investment bank Lehman Brothers have mostly been forgotten or watered down. U.S. policymakers aren't likely to break up big banks or ban exotic derivatives. "The industry is not losing as badly as it thought it might," says Oliver Ireland, a former associate general counsel at the Federal Reserve and now a partner at law firm Morrison & Foerster in Washington, D.C. But investors will still have to deal with a shifting regulatory landscape. In mid-December, the House passed measures that will boost oversight of stockbrokers, credit rating agencies, and complicated investments, as part of broader reforms that include the Consumer Financial Protection Agency. The Senate will consider similar provisions early next year. Here are five areas where the actions of lawmakers are likely to influence the portfolios of individual investors—and where regulators such as the Securities & Exchange Commission are already making waves.

–With Alison Vekshin in Washington, D.C., Ben Levisohn and Michael J. Moore in New York, and Mark Scott in London

Financial Fixes

PROBLEM



FRAUD

Bernard Madoff perpetrated a $50 billion scheme in which he falsified paperwork for more than a decade. Madoff ensnared 15,000 investors, big and small, and gave the SEC a black eye.



CONFLICTS OF INTEREST

Credit-rating agencies, including Moody's and Standard & Poor's, failed to detect flaws in mortgage bonds and other debt. Some risky securities that had the highest rating, AAA, dropped to junk.



TOXIC BONDS

Governments sold investments that imploded. Jefferson County, Ala., issued munis linked to exotic financial instruments to build sewers. The borrower defaulted and the county's bondholders got burned.



BIASED ADVICE

Stockbrokers who collected fat commissions sometimes acted like financial advisers. There's a legal distinction: Advisers must put their clients' interests first, brokers only have to market "suitable" investments.



SPECULATION

Oil prices spiked to a record high in 2008 as hedge funds and other financial players poured money into the commodity.

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SOLUTION	CHANGE
As the SEC ramps up enforcement, policymakers want to make it harder for con artists to pass off fraudulent documents. A House bill that just passed calls for better oversight of investments, and it would require money managers with more than $10 million to use an independent custodian for client accounts; the Senate may consider a similar measure next year as part of its reforms. Madoff used a custodian that he controlled, which made it easier to falsify investment records.	The move should offer a bulwark against some fraudulent activities, though it is by no means a cure-all. Legislating against immoral behavior is difficult, says Kurt Brouwer, chairman of financial advisory firm Brouwer & Janachowski in Tiburon, Calif. "I'm not sure you can do that."
U.S. lawmakers in both the House and Senate are pushing for improved disclosure. They want to require raters to release details about how they are paid. To make risks clearer to investors, they want issuers to provide information about the underlying assets of a bond. In Europe, rating agencies will soon have to register with regulators and reveal the methodologies behind their credit decisions. Independent board members will also have to scrutinize ratings on the Continent.	The proposed changes may improve the quality of bond ratings, but they don't address a central issue: Credit agencies are paid to rate bonds by the companies that issue them. Bond investors may have to live with that. "We've taken the position that you've got to kind of ignore the rating agencies entirely...and just go do the credit work yourselves," says Mackin Pulsifer of Fiduciary Trust, a money manager for wealthy individuals.
Lawmakers worry that small municipalities don't have the resources to vet exotic investments. Under the House bill and the Senate proposal, financial advisers to muni issuers would have to register with the SEC and follow a new set of rules for dealing with municipalities.	The plan may decrease the likelihood that a municipality runs into financial trouble and could help protect investors from a bond blowup. But the new rules won't prevent all the problems that have plagued the muni market—or local government. In Jefferson County, a former official involved in the sewer debt deal was found guilty in late October of accepting bribes.
Brokers providing investment advice to retail investors would also have to act as fiduciaries, putting clients' interests first, if pending legislation passes both the House and the Senate. Brokers who simply execute trades would be exempt. The SEC may also issue rules for "simple and clear" disclosures about a broker's potential conflicts of interest.	Many industry players say the move will improve the quality of investment advice. Higher compliance costs—which could cut into profits—may drive some smaller brokers out of business. "There will be a lot of brokers making a lot less money," says Bob Williams, a broker with Delta Trust Investments in Little Rock. "But I think it's for the best."
Regulators want to curb speculation, which some blame for the run-up in commodity prices. The U.S. Commodity Futures Trading Commission and the New York Mercantile Exchange, for example, are capping the amount of grain, oil, and other commodity-based derivatives known as futures contracts that a money management firm can buy.	Managers of exchange-traded funds that buy commodities may run afoul of the new limits. To avoid that situation, some firms have preemptively shut down funds or stopped issuing new shares. On Sept. 1, Deutsche Bank announced it would shutter PowerShares DB Crude Oil Double Long, an exchange-traded product geared toward individuals. If more follow suit, small investors may have fewer options to diversify their portfolios.

HARRY CAMPBELL

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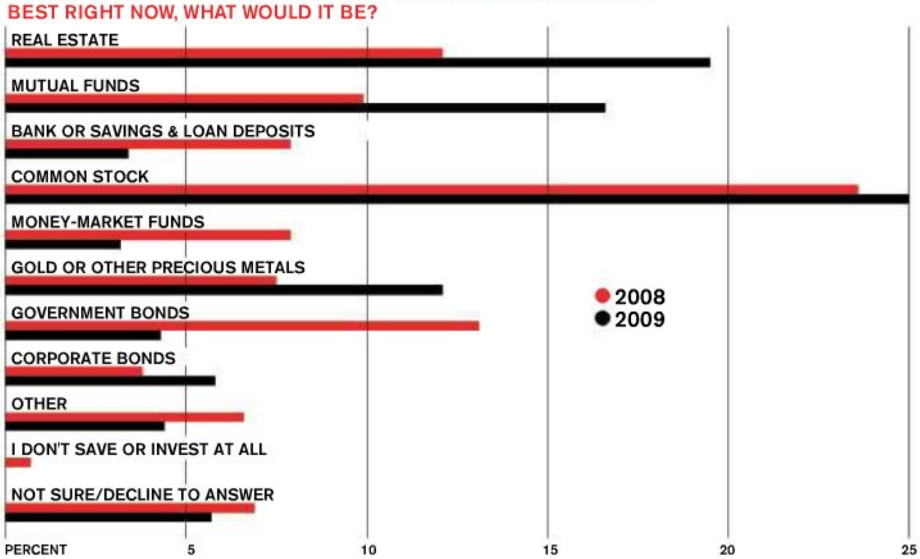
INVESTORS START TO LOOSEN UP

Americans are venturing away from the safest harbors, though gold is still popular. *By Peter Coy*

A *Bloomberg BusinessWeek* poll finds that investors are less fearful than they were a year ago, at the height of the financial crisis. Real estate has regained favor, as have mutual funds. Gold is big, too—a sign that some investors are worried about inflation and a sinking dollar. Meanwhile, safe government bonds and money market funds have lost popularity. Betraying their home bias, American investors are much more likely than foreign investors to pick the U.S. as the market with the best potential. *Bloomberg BusinessWeek* Research Services conducted online interviews with 770 American investors and 158 foreign investors from Dec. 1-8.

Renewed interest in mutual funds and real estate

IF YOU HAD TO CHOOSE ONE INVESTMENT YOU THINK WOULD BE BEST RIGHT NOW, WHAT WOULD IT BE?



Americans pick their own stock market as 'most likely to succeed'

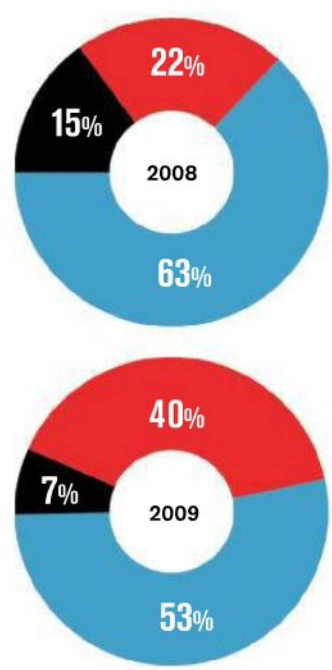
WHAT COUNTRY'S STOCK MARKET DO YOU THINK WILL PRODUCE THE BEST RETURNS FOR INVESTORS OVER THE NEXT 12 MONTHS?



Americans are increasingly likely to look abroad

HOW DO YOU THINK YOU WILL CHANGE YOUR PORTFOLIO OVER THE NEXT FIVE YEARS?*

- DIVERSIFY TO BE MORE EXPOSED TO INTERNATIONAL STOCKS
- RESTRUCTURE INTO MORE U.S.-BASED STOCKS
- NOT CHANGE MY MIX OF U.S. AND INTERNATIONAL STOCKS



*Responses of U.S. investors

CHARTS BY DAVID FOSTER/BW

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Global Opportunities

THE ACTION STAYS OFFSHORE

BY BEN STEVERMAN



SEEK PROFIT FROM strong economies in emerging markets, where demographics and government policies are driving impressive growth. That's advice barely dented by the recession and financial crisis. But this wisdom comes with caveats: These markets are particularly subject to currency swings, overheating, and unexpected shocks. And it doesn't take a bombshell of Dubai World dimensions. In October, Brazil levied a 2% tax on foreign investments in its financial markets, saying it wanted to prevent currency appreciation. The tax caused foreign investor participation on Brazil's exchange to fall to 29.5% in November, vs. 33.7% in October, says Deutsche Bank analyst Mario Pierry.

For the brave, there are plenty of ways to get in on the action. Consider Western consumer products companies, such as Cadbury, which gets a third of its confection sales from developing nations. Some investors seek out commodity producers or technology and health-care companies that cater to the developing world's expanding middle class. Then there are the emerging markets' own success stories—companies growing faster than their dynamic domestic economies.

Bloomberg BusinessWeek asked international investing experts to recommend companies likely to join the ranks of global blue chips over the next five years. The challenge was to identify companies

PHOTOGRAPH BY **DAN SAELINGER**

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Looming large: Bovespa aims to be the stock exchange for Latin America

that are growing rapidly, have sustainable business models, and are large enough to contend for dominance of their industries.

Buying shares may not be so easy: Of our experts' picks, only Wipro Technologies, the Indian conglomerate, is listed on a major U.S. exchange. Some discount brokerages provide access to foreign markets in Europe and Japan, but stocks in countries such as Brazil can be harder to buy, making a full-service brokerage the best bet.

BOOMING BOVESPA

Brazil is likely to be home to a few new global giants. But rather than guess who will prosper, bet on the company's exchange. BM&F Bovespa, a favorite of Richard Parower, manager of Seligman Investments' Global Technology Fund, is the country's only major financial exchange, offering investors a way to profit from Brazil's growth—gross domestic product is expected to jump 4.75% in 2010. The exchange is in talks with Chile, Colombia, and Mexico for cross-listing of shares. "They're positioning themselves to become the stock exchange for Latin and South America," Parower says. In October, Bovespa's stock trading volume hit a record $4.2 billion a day, up 38% from the year before, while fixed-income and derivatives volumes rose 12.5%.

The exchange has teamed up with CME Group, the world's largest futures and options exchange, and Nasdaq. It's also investing in technology to build a world-class trading platform. Says Adam Sussman, director of research at TABB Group, a capital markets advisory firm in Westborough, Mass.: "The faster they are, the more efficient their market will be [and] the more capital they attract." The value of the exchange's new share offering tripled from the first to the second half of 2009. Next year, analysts expect revenues to grow 26.5%, to $1.1 billion. The exchange's stock, at 6.89, is up 101% for the year.

A big risk to BM&F Bovespa's stock is the possibility that the Brazilian economy and markets may overheat, creating an asset bubble that could cause the government to intervene.

INFO-TECH BEHEMOTH

India's Wipro is another emerging-market company that is showing impressive growth. Sales have more than doubled since 2006. Like many Indian conglomerates, Bangalore-based Wipro boasts a mind-boggling range of businesses: truck parts, deodorant, and energy consulting, for starters. But Wipro is best known for its information-technology business, which makes up 88% of its $5 billion in sales and has many Western companies as clients, including Microsoft and BP. Revenues grew 11.8% in 2009, slower than its previous 30%-plus pace. Analysts expect revenue to reach $7.3 billion by 2012. Wipro's stock is up 148% in the past year, to 20.12.

Seeking to roll out more sophisticated services and products to its technology clients, Wipro has made nine acquisitions since mid-2007. In April it bought Nokia's mobile broadcast unit for $127 million, enhancing its ability to develop mobile information technology applications for telecom clients. So far, Wipro has managed to keep its profit margins high, at 31.5%. But that could be difficult to maintain as it makes acqui-



MY FAVORITE INDICATOR

Sarah Ketterer

CEO and Portfolio Manager Causeway Capital Management

I'm watching volatility. The MSCI World Index, which tracks developed markets, had an average annualized return of 10% over the past 30 years. Volatility, or the risk that the index's returns would swing wildly compared with historic norms, averaged 15%. In the credit crisis, it shot to more than 40%. It's now 25%. If volatility begins to rise again, that's reason to be more cautious. For now, as volatility trends down, equity returns should trend up: The 15-year annualized return for the MSCI World is 6%, well below the 10% long-term average. *—as told to Tara Kalwarski*

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Danone: More of its new products are geared toward emerging markets

sitions in more expensive parts of the globe. "They've been pretty careful," says Moshe Katri, an analyst at New York investment bank Cowen, noting that the company favors smaller acquisitions, which allow it to keep most operations in low-cost countries.

FOREIGN CACHET

Not all the companies benefiting from growth in emerging markets call those markets home. France's Danone, specializing in water, dairy products, and baby formula, has moved aggressively into two to three new countries each year. "Danone is gaining a lot of market share in emerging markets, where people view a foreign brand name as very attractive," says Virginie Maisonneuve, head of global equities at Schroders Investment Management, which owns Danone stock. Sales in Europe rose 4.1% in the last year, but in Asia and the rest of the world they increased more than 10%. In China, Danone boosted the market share of its dairy business by 15.7 percentage points last year. It also got into a dispute with partner Hangzhou Wahaha Group and exited the joint venture. Its stock is up 2% in the past year, to 60.40.

Danone's sales and market share have expanded partly because the company has been able to lower prices while preserving profit margins. In some cases, that meant adjusting the size of its packaging; in others, the company launched new marketing campaigns. Danone's products in development are geared toward emerging markets, including a line of fortified food products designed to give poor people the nutrients they often miss.

BEYOND BEER

While heavily dependent on sales in their home country of Japan, Brewer Kirin and privately held beverage company Suntory are beginning to pursue a global strategy similar to Danone's. They're also working on a merger, with approval expected in early 2010. According to Euromonitor International, a London market research firm, their combined sales could exceed $41 billion, more than that of Coca-Cola. The merged company could cut costs while sharing an increasingly large distribution network, says Hope Lee, a Euromonitor analyst. Kirin's stock is up 19.1% in the past year, to 15.63.

Taking advantage of the strong yen, both companies are on buying sprees. According to Bloomberg data, Kirin bought more overseas assets than any other Japanese company in the first 11 months of 2009, spending a total of $4.6 billion for Australian brewer Lion Nathan and for a stake in the Philippines' San Miguel Brewery. On Oct. 26, Kirin said it wanted to get 30% of sales and profits from outside Japan—mostly China and the Pacific Rim—by 2015. Less than two months later, Kirin boosted its stake in a Chinese soda venture, Shanghai Jin Jiang Kirin Beverage, to 93% from 57.7%.

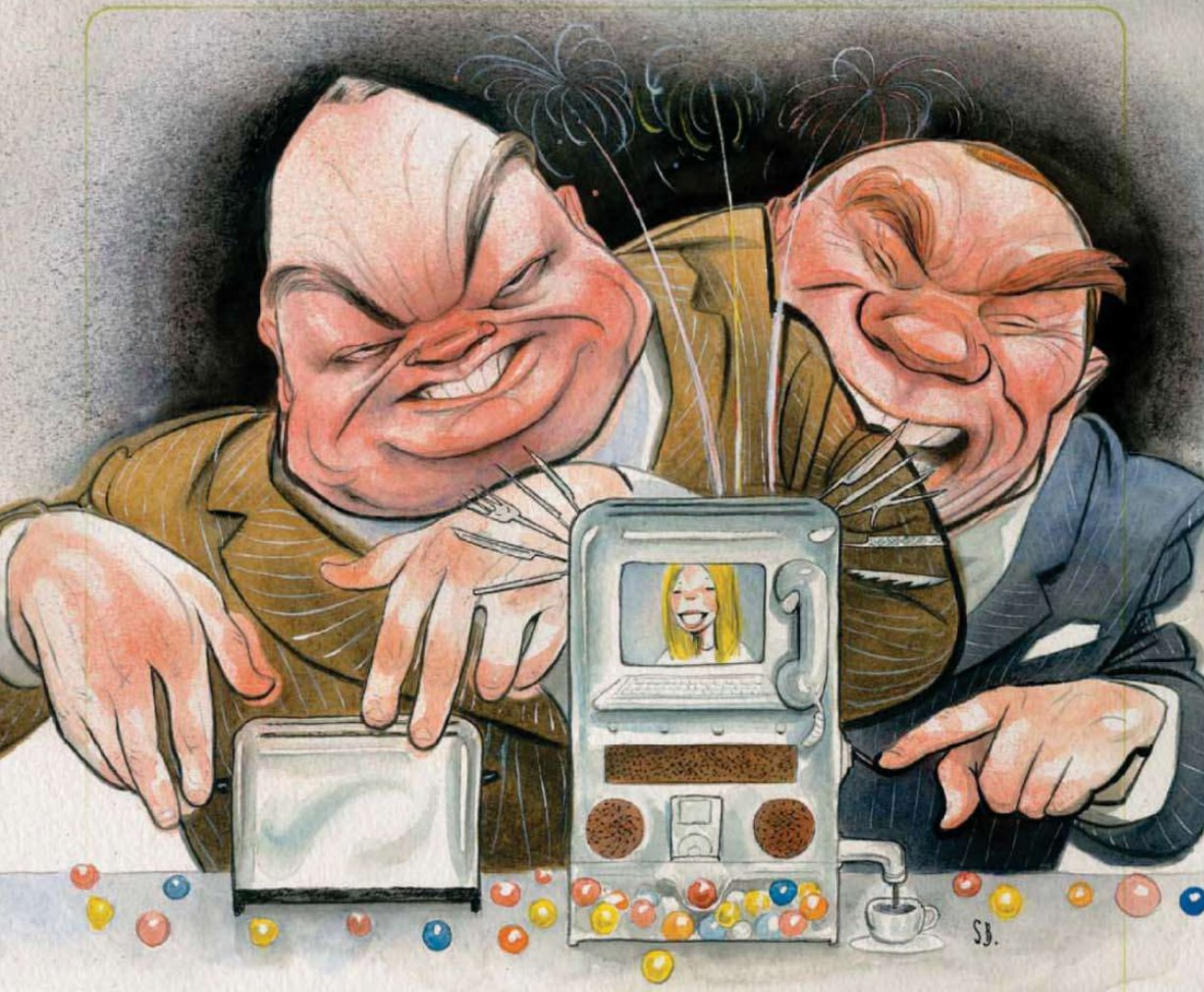
BOVESPA, WIPRO, DANONE, AND KIRIN. THESE COMPANIES MAY JOIN THE RANKS OF GLOBAL BLUE CHIPS IN THE NEXT FIVE YEARS.

Suntory, meanwhile, has made seven acquisitions in the past two years, with recent targets in Australia, Thailand, and Austria. In December it bought 70% of a Hong Kong-based wine importer, ASC Fine Wines Holding. "This is a new thing" for Japanese companies, says Euromonitor's Lee. "We don't know how their brands are going to perform in these countries."

No one can predict with any certainty how these stocks will perform in investors' portfolios, either. But with economic growth around the world outpacing that of the U.S., it may be well worth finding out. |BW|

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BRAZIL, CHINA —AND PAKISTAN?

Legendary Templeton manager Mark Mobius says low debt and strong growth will buoy emerging markets. *By Frederik Balfour*

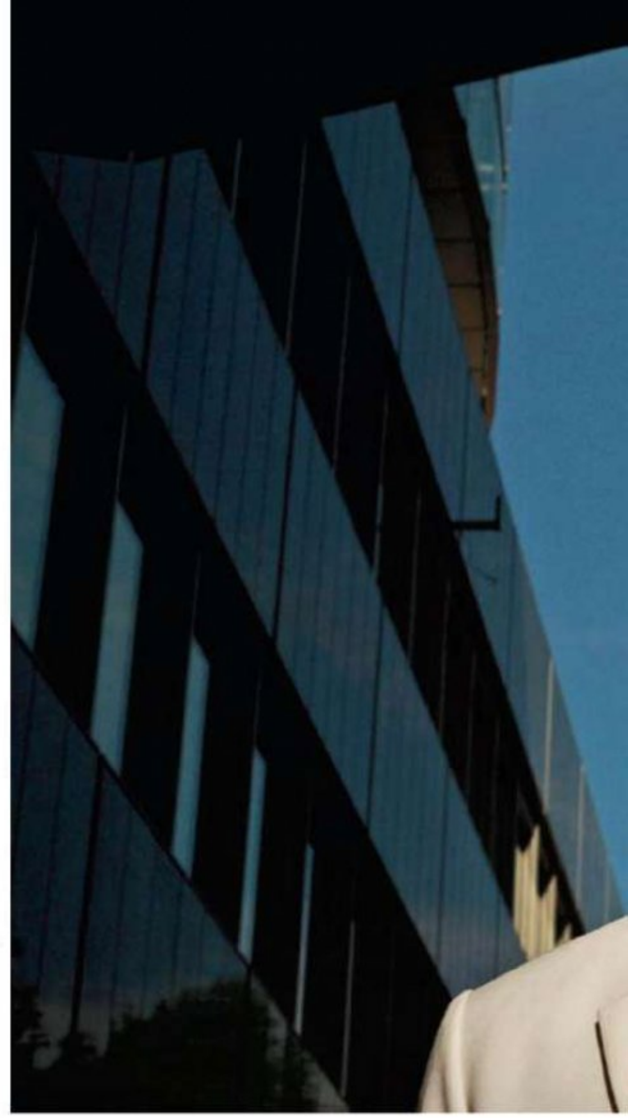
Mark Mobius is a legend among emerging-market investors. For more than 30 years, the 73-year-old fund manager, who oversees $33 billion spread across 35 Franklin Templeton funds, has scouted for investment opportunities in unlikely places. His U.S.-listed Templeton Emerging Markets Fund had a 109% return as of Dec. 14, compared with 73% for the MSCI Emerging Markets Index. Hong Kong-based correspondent Frederik Balfour caught up with Mobius by phone as the fund manager was visiting Doha, Qatar—one stop on an itinerary that included Dubai, Lebanon, Saudi Arabia, and Libya.

What was behind the huge runup in emerging markets in 2009?
With the subprime shock, everybody was looking for safety. And for some strange reason, they thought the U.S. dollar was safe and went into money market funds until January or February of 2009. Then people began to wake up to a few things. One was that the supply of currency would at some time outpace demand, so value would decrease. In China there was 21% growth of money supply, and in the U.S. 18% to 20%. That created this incredible liquidity looking for a home as people woke up [to the fact] that they should think about inflation coming down the pike. They weren't getting any yield on dollar deposits, so equities were the obvious answer.

Have emerging markets moved too far too fast?
The percentage increases are a bit misleading because you are coming from a low base. We are only halfway toward the previous high of 1997. Have we gone too far? The only measure we have is valuations, and probably the best single measure is price-to-book value ratio. [Book value is a measure analysts use to estimate what a share of stock would be worth if all the company's tangible assets—factories, real estate, and so on—were liquidated.] If you look at the average price-to-book ratio based on the stocks in the MSCI Emerging Markets Index, we are only halfway to the 1997 high. The absolute high was three times book, the low was one times book, and now we are at two times book, roughly.

Could things reverse course?
You better believe there are a lot of hedge funds out there betting against this rally. That provides more volatility. It's a self-feeding situation. You have to be aware that the volatility will be there and there is nothing you can do about it.

Apart from all the money in the system, what is driving the emerging-market rally?
Fundamentals. If you look at any time period—10 years, 3 years, 1 year—emerging markets have outperformed U.S. and global markets. Their economies are growing faster, four times faster. And during the 1997-1998 Asian crisis [policymakers in] emerging markets realized they needed strong balance sheets at the national and company level and had to build up foreign reserves, which they've done. They were building up reserves, keeping their currencies low, and reducing debt. Their debt-to-



PIOTR MALECKI/GETTY IMAGES

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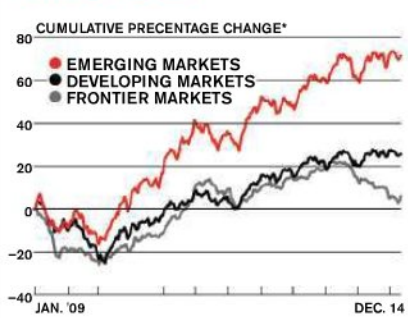
Mobius is investing in consumers and commodities

gross-domestic-product levels are way below developed markets, and when you look at the foreign exchange picture, it's even more impressive. Russia has $400 billion in reserves; China, $2 trillion. So where do you want to put your money? Obviously, emerging markets are the place.

How did the panic caused by property developer Dubai World's debt woes affect the appetite for emerging-market stocks?
There was some retreat, but it was very short-lived. Dubai keeps on tanking because of uncertainty. Emerging markets hardly missed a beat.

What markets are you keen on?
Brazil and China. Our funds are big, so obviously we want to be in a place where there is good liquidity. But we are also looking at many other markets. We have a frontier-markets fund that we launched about a year ago—we have one fund in the U.S., one in Europe, and one in Korea. Korean investors have become quite global.

Emerging Markets Take Off



Data: Bloomberg *Calculated using MSCI indexes

CHART BY DAVID FOSTER

What new markets have you entered?
Well, I was just in Libya and Algeria, though it will be a while before we [invest] there. I am speaking to you from Doha in Qatar, then I'm on to Jordan, Lebanon, and Saudi Arabia and back to Dubai. We are investing in all those countries. There is money coming into our funds, and we see opportunities. Obviously with the high degree of uncertainty, you see an overreaction in Dubai [so there are buying opportunities]. Qatar has gas exports taking off, and it's going to have a lot of money to invest. They are building this incredible infrastructure and investing in technology. We are investing in Qatar Steel and Qatar National Bank. In Dubai, we are investing in Emaar Properties and DB World, the ports company.

We continue to hold on and buy in India. In Pakistan, we are probably overweight compared with everyone else. For our Asia growth funds, we have been buying Pakistan Telecom, MCB Bank, and Indus Motor, which is a Toyota assembler and distributor. In Iraq, we haven't gone in yet. We have a private equity fund looking at it as well. There is a stock exchange, by the way. And Iran has a big market. When and if things get better, that would be an obvious place to hit.

What themes are you investing around?
Commodities are a main theme. We are looking at $70 per barrel in our model. Another theme is consumers, because the per capita income of consumers in emerging markets is going up. We hold retail chain Massmart from South Africa, which is beginning to move north to other countries. In Kenya, [we hold] East African Breweries. As for telcos, we find them expensive and think the chances of growth are diminishing. It's a bit like the airline industry. You have to keep on investing and buying expensive licenses where the government takes you for a ride.

How do you expect emerging markets to perform in 2010?
You cannot expect the same kind of percentage increases, but that doesn't mean you can't have a very good return. We are not in the mode of selling massively or getting into cash, that's for sure. That's probably the consensus opinion, which is usually dangerous. But we are finding companies with good dividend yields, companies that are growing. |BW|

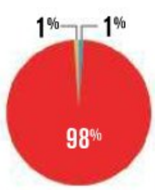
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NEW FRONTIERS

The MSCI Frontier Markets Index tracks emerging nations with smaller, less liquid, and riskier markets. It was up 8% in 2009 (as of Dec. 14). And low valuations, coupled with big profit forecasts, may mean that markets in regions like Africa and the Middle East perform even better in 2010. Below, some funds offering diversified exposure. *By Tara Kalwarski*

- AFRICA/MIDDLE EAST
- ASIA
- EUROPE
- LATIN AMERICA

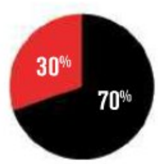
Eastern European Equity VEEEX



79%
2009 TOTAL RETURN

Over the past 10 years this fund has returned an average 14% a year. Morningstar gives it five stars, the highest possible rating. The top holding, at 9% of assets, is Rosneft oil company in Russia.

Fidelity Emerging Europe, Middle East, Africa FEMEX



56%
2009 TOTAL RETURN*

This fund's top 10 holdings, which include South African telecom MTN Group, Czech utility Cez, and Teva Pharmaceutical Industries in Israel, account for about half of the portfolio. The expense ratio is 0.98%.

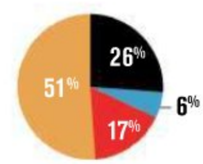
SPDR S&P Emerging Middle East & Africa GAF



49%
2009 TOTAL RETURN*

With a 0.59% expense ratio, this ETF is an inexpensive option. It provides exposure to companies in Egypt, Israel, Jordan, Morocco, and South Africa, and boasts a 4.2% yield.

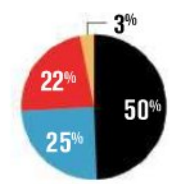
Claymore/BNY Mellon Frontier Markets FRN



56%
2009 TOTAL RETURN*

One of the only offerings with a big Latin America allocation, this fund has almost 33% of assets invested in Chilean companies like electricity giant Enersis. Polish stocks make up 14% of assets.

Templeton Frontier Markets TFMAX



43%
2009 TOTAL RETURN*

Launched in October 2008, this fund seeks to invest at least 80% of assets in frontier markets. More than 40% of assets are in small- and micro-cap companies, including East African Breweries.

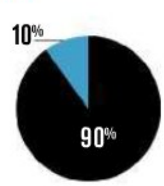
Market Vectors Africa Index AFK



34%
2009 TOTAL RETURN*

This ETF tracks an index of stocks that are headquartered in—or generate most of their revenue from—Africa. Manager Van Eck also runs ETFs that invest in single-country frontier markets like Vietnam.

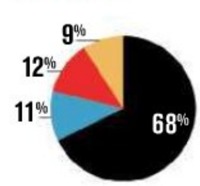
T. Rowe Price Africa & Middle East TRAMX



24%
2009 TOTAL RETURN*

Morningstar considers this fund "one of the boldest" among emerging-market funds and notes that it is highly concentrated. Almost half its assets are in the financial services sector, like Bank Muscat in Oman.

Morgan Stanley Frontier Emerging Markets FFD



25%
2009 TOTAL RETURN*

About a quarter of this ETF's portfolio is in companies located in Qatar and the United Arab Emirates. But its 2.28% expense ratio is one of the steepest among frontier market funds.

WisdomTree Middle East Dividend GULF



7%
2009 TOTAL RETURN*

The 56 stocks in this ETF's portfolio are all located in the Middle East and pay regular cash dividends on shares of common stock. More than two-thirds of assets are invested in financial and telecom companies.

PowerShares MENA Frontier Countries PMNA



8%
2009 TOTAL RETURN*

Top holdings in this Middle East- and Africa-centric ETF include Arab Bank in Jordan, United Arab Emirates-based Emaar Properties, and Maroc Telecom in Morocco; 90% of assets are in large- and mid-cap companies.

CHARTS BY JOE RHAMES/BW

*As of Dec. 14; region allocations are most recent estimates Data: The companies, Bloomberg, Morningstar

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BONDS: FINDING THE SWEET SPOT

While rising interest rates around the world could spell a tough 2010 for bond investors, fund managers say possibilities for profit remain.

By Ben Levisohn

When the final returns for 2009 are tallied, they'll likely show that investing in risky bonds was a can't-miss proposition this year: Everything from U.S. corporate "junk" bonds to emerging-market government issues rallied. Will the same hold true in 2010? "I wouldn't expect it," says Chris Diaz, co-manager of the ING Global Bond Fund.

Most pros agree that rising interest rates will take a bite out of many kinds of bonds, and soon. As the global economy rebounds, central banks are beginning to signal that the era of near-zero interest rates won't last much longer. Rising rates are generally bad for bonds, whose prices move in the opposite direction of the interest rates the bonds pay. It might seem like a paradox, but the more slowly any given nation recovers from the global downturn, the better the outlook for its bonds will be, because its central bank will be less likely to raise rates.

The European Central Bank, famously hawkish on inflation, seems bent on boosting rates sooner rather than later, despite a struggling financial sector and slow growth in the region. That could make government and corporate bonds in the euro zone a bad bet.

The U.S. Federal Reserve, too, seems likely to raise rates in 2010. The futures market is pricing in an 80% chance of a hike by September. That could lead to a pop in Treasury yields. "It wouldn't take much of a rise in interest rates to wipe out your [bond] income," says Andy Johnson, head of investment grade fixed income at advisory firm Neuberger Berman.

Britain, however, isn't rushing to hike rates. Its economic problems are likely worse than those in the U.S., and the British central bank could wait until 2011 before moving rates up, says Jeffrey Elswick, director of fixed-income at Frost Investment Advisors. British government bonds "should be one of the better performers in 2010," he says.

Rising rates could be messy for so-called investment-grade corporate bonds—those rated above BB+ by Standard & Poor's and Fitch, or Ba1 by Moody's Investors Service. (Those rated lower are commonly known as junk bonds.) The 2009 rally has brought yields down sharply. The difference in yield—known as the spread—between a typical investment-grade bond and a comparable Treasury bond is now 1.3 percentage points, just 0.5 percentage points higher than during the credit boom. If interest rates rise too quickly, investors could be left holding pricey corporate bonds that pay only slightly more than Treasury bonds but offer far less safety, a recipe for swift selling.

One sweet spot in corporate bonds may be emerging, however. David Albrycht, portfolio manager of the Virtus Tactical Allocation Fund, is focusing on the lower end of the investment-grade spectrum. He has been buying bonds rated BBB, including a Principal Financial Group security that matures in 2019 and yields around

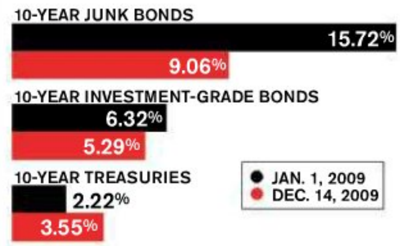
ILLUSTRATION BY ALEX NABAUM; CHART BY ALBERTO MENA/BW

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The Yield Story

In 2009, bond investors started taking risks again. That's pushed prices up and yields down on nearly everything. Everything, that is, except U.S. Treasuries.



Data: Bloomberg

6.7% and an Equifax bond that matures in 2017 and yields 5.53%. Even if interest rates rise, he says, the prices of BBB bonds won't necessarily fall. That's because their yields will still be high compared with Treasuries, so there shouldn't be a big sell-off. Investors can achieve a similar result investing in higher-quality junk bonds. Says Albrycht: "There's 24 months left of upside."

SHORT-TERM STRATEGY

If interest rates do rise, so-called floating-rate debt could be one of the better plays, says Derek Brown, director of fixed income at Transamerica Investment Management. These bonds don't have a fixed interest rate; the payments change periodically. The Transamerica Flexible Income fund owns floating-rate bonds from Bank of America, State Street Capital, and others. If rates start to go up, the interest payments of these bonds will rise with them. The downside? Until rates start rising, these bonds will keep paying next to nothing. The State Street bond paid just 1.25% on Dec. 15; the Bank of America bond, just 0.54%. "When the Fed starts raising rates, these will be a nice thing to have," Brown says.

Another strategy that could pay off: sticking with mutual funds stuffed with short-term bonds so that as rates rise the fund manager can replace the lower-yielding bonds with higher-yielding ones. Start by looking at a fund's "duration," a measure that shows how sensitive its value is to moves in interest rates. If a fund's duration is, say, 1.5 years, it means the fund will decrease about 1.5% in value if interest rates rise 1%, and it will increase 1.5% if rates fall by the same amount. For this strategy, the lower the duration, the better. That could mean choosing a fund like the FPA New Income Fund, which has an average duration of just 1.25 years. Its low-risk strategy paid off in 2008, when it outperformed 86% of its peers. This year the fund is up just 3.4%. (It tends to outperform when others are blowing up.)

More managers are bringing the duration down in their funds. Two top performers this year, the Marshall Short-Intermediate Bond Fund, which gained 27.7% through Dec. 11, and the Putnam Income Fund, which is up 43.6% year-to-date, have also experienced two of the largest drops in duration. The $180 million Marshall fund's duration dropped to 4.92 years at the end of September from 6 years in June, while the $1.2 billion Putnam Income Fund dropped from 6.25 to 5.48. Says Larry Rosenthal, president of Financial Planning Services in Manassas, Va.: "That's the sign of a manager trying to protect his gains." | BW |

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A TOUGHER SEARCH IN REAL ESTATE

With big returns already realized, investors will want to tread cautiously—but there are still bright spots, particularly in Hong Kong and some emerging markets

By Amy Feldman



Hong Kong property stocks are up, and China's growth may keep them there

GREGOR LENGLER/LAIF/REDUX

Anyone considering an investment in international real estate today is bound to do so with at least a twinge of regret. After a dismal year, the S&P Global Property Index has more than doubled from its Mar. 9 low, and it seems everyone has already cashed in. Among the 44 mutual funds and half-dozen exchange-traded funds (ETFs) invested globally, "The returns are really gaudy for the year," says Morningstar analyst John Coumarianos.

Higher property valuations worldwide are making real estate securities less attractive, while Dubai's debt woes highlight the sector's risks. So most investors will want to keep global real estate to a sliver of their portfolios, gain new exposure slowly with dollar-cost averaging, and stick to broad-based funds rather than country- or region-specific offerings.

The eye-popping returns since last March may be gone as investors already anticipate—and price in—a global real estate recovery. But experienced investors say there are still values to be found in Asia, Australia, Europe, and selected emerging markets such as Brazil. With credit markets stabilized, a shakeout is starting. For investors, that means there are chances to get in on distressed investments and to buy stronger real estate operators as they position themselves to acquire weaker rivals. Longer-term, real estate is a play on economic expansion: Growth means more demand for housing and office space, which will ultimately be reflected in higher (or at least stable) rental prices and lower vacancy rates. "The recovery is starting in Asia and working its way to Europe and the U.S.," says Thomas Bohjalian, a global real estate portfolio manager at New York-based Cohen & Steers, which manages $23 billion. "We don't believe there will be as much distress as people believed, but the opportunities will be large."

As the recovery takes hold in Asia, China, with its strong growth prospects, is a key focus. Michael Winer, manager of Third Avenue Real Estate Value Fund, which buys in the U.S. and overseas, has long looked toward Asia, and especially Hong Kong, rather than to U.S. real estate investment trusts. Among his fund's top holdings as of Oct. 31 is Henderson Land Development, a financially strong Hong Kong company also building in mainland China. Bruce Eidelson, director of real estate securities at Tacoma (Wash.)-based Russell Investments, likes China Resources Land, a Chinese residential developer listed in Hong Kong, as well as Henderson Land. "You're seeing a lot of activity in China because of the need for upgraded housing stock," he says. "The Hong Kong market, while it has performed exceptionally well, should still benefit from growth in China."

Asia's other major market, Japan, is another story. Its economy is stagnant and, until November, real estate traded at big discounts. "We think it is more fairly valued today than a month ago," says Cohen & Steers' Bohjalian. He expects Japan's real estate market recovery to lag behind that of Hong Kong and Singapore. "On a fundamental level, Japan is a late-2010 or 2011 story," he says. Investment managers say they are steering clear of J-REITs, or Japanese real estate investment trusts, that peaked in 2007 and have faced

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major financial difficulties. Instead, they favor real estate operators with the best properties and strongest balance sheets, including Mitsubishi Estate and Mitsui Fudosan. "We believe both are trading at double-digit discounts to what their real estate holdings are worth," says T. Ritson Ferguson, chief investment officer of ING Clarion Real Estate Securities, which manages a number of ING real estate mutual funds.

Australia, where the economy has held up and many property companies offer dividends of more than 7%, is also promising. ING's Ferguson likes Westfield Group, a mall owner; Dexus Property Group, a commercial developer; and Stockland, whose operations span office buildings, warehouses, and malls.

In Europe, the prime target remains the United Kingdom. While problems in the economy, banking sector, and property markets mirror those of the U.S., British property valuations are more depressed. "It's not that fundamentals are better than in the U.S., but that stock prices have taken a bigger hit. Companies there have been quite aggressive about marking down assets," says Russell's Eidelson. He likes Derwent London, a REIT that's focused on that city's West End office market.

Farther afield, Samuel Lieber, manager of Alpine International Real Estate, bets heavily on emerging markets and especially on Brazil, which represents 26% of his $754 million fund's assets. That big bet has helped Alpine International soar 124% over the past year. The Brazilian stocks Lieber likes include MRV Engenharia, which builds affordable housing; shopping mall developer Iguatemi; and Cyrela Commercial Properties. "Our international fund is heavily in emerging markets because that's where the opportunities are," says Lieber, whose Purchase (N.Y.) firm, Alpine Woods Capital Investors, launched a separate emerging markets real estate fund last year. With Brazil scheduled to host the World Cup in 2014 and the Olympics in 2016, he says, "there's huge upside there over the next five years." And that, after all, is what all investors hope for. |BW|



MY FAVORITE INDICATOR

Mark Zandi

Chief Economist, Moody's Economy.com

The figure that matters to most people is jobs.

An accurate and timely barometer for that is initial claims for unemployment insurance. Released every Thursday morning by the Labor Dept., this indicator measures the number of people who go to unemployment offices and announce that they are out of work.

In the first half of 2009, more than 600,000 initial claims were made each week. But since July, the numbers have fallen to about 450,000, which means that the economy is recovering. So far, the economy has had trouble evolving from recovery to expansion because businesses are still shell-shocked and are not hiring. Only when initial claims head toward 400,000 will the economy be creating enough jobs to maintain stable unemployment. Closer to 350,000 will lower the unemployment rate and mean that this recovery is evolving into an expansion. When we get to initial weekly unemployment claims of 300,000, boom times are back. *–as told to Tara Kalwarski*

International Real Estate: The Lay of the Land

Dozens of mutual funds and exchange-traded funds (ETFs) invest in global real estate. Here are five smart options for investors looking at property markets around the world.

Name/TICKER	Assets	1-Year Return	3-Year Return	Strategy
Alpine International Real Estate/EGLRX	$754 million	123.6%	-14.2%	Sam Lieber's fund is volatile, but in good times it soars. He bets big on emerging markets; Brazil represents more than one-quarter of the portfolio.
Cohen & Steers International Realty/IRFAX	1.4 billion	45.3	-11.2	Sticks fairly close to its benchmark, the S&P Developed ex-U.S. Property Index. Biggest stakes: Australia (22%), Japan (20%), and Hong Kong (17%).
ING International Real Estate/IIRAX	558 million	39.0	-9.0	A large-cap value fund tilted heavily toward Asia, with 71% of assets recently invested there.
SPDR Dow Jones International Real Estate/RWX	957 million	41.5	n/a	This ETF tracks the Dow Jones Global ex-U.S. Select Real Estate Index. More than one-third of its holdings are in Australia and Japan.
Third Avenue Real Estate Value/TAREX	1.4 billion	49.6	-10.8	A deep-value fund that invests in the U.S. and abroad and has its largest stake in Asia, with a focus on Hong Kong.

Returns through Dec. 14

Data: Morningstar, company reports

ANDY FRIEDMAN

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The Risks Ahead

WHAT TO WORRY ABOUT NOW

BY BEN LEVISOHN



THE DEFINING event for the world's currencies through most of 2009 was the steady and steep decline of the dollar. In 2010 the dollar will be center stage again—only this time it will be a highly volatile greenback that challenges investors.

In 2009 Asia and Latin America had more dynamic economies than the U.S., so buying securities abroad was a no-brainer: Americans invested $46 billion in overseas markets. That shift put downward pressure on the dollar. So did massive trade and budget deficits in the U.S., a low interest rate policy by the Federal Reserve, and the slow erosion of the dollar's role as the world's reserve currency. The greenback slid almost 17% between early March and late November against a basket of major currencies—the biggest decline for the dollar in any eight-month period since 1986. Investors who shunned dollars also enjoyed a currency boost that added to their return. The Brazilian Bovespa index, for example, rose 85% for the year when measured in the local currency. But the Brazilian real has grown so powerful that the Bovespa's 2009 performance, when translated into dollars, is an even higher 148%.

At the end of 2009, though, the markets got a sharp reminder of how volatile currencies can be. In just a few days the Dubai World bond fiasco and the Greek sovereign debt downgrade drove investors

PHOTOGRAPH BY **DAN SAELINGER**

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to seek refuge in the recently scorned dollar. U.S. treasuries were snapped up, the euro slumped, and the dollar rose 2.5%.

Investors now anticipate more such blowups and subsequent dollar rallies. That scenario doesn't change the prognosis of overall weakness for the dollar. But with the fragile finances of Britain, Japan, Russia, Spain, Ukraine, and other nations increasing the chances of a scary market event, the dollar's straight-line decline is no longer a given.

So how should investors handle the new volatility? Those who can stomach wild swings can still bet heavily on the dollar's decline. The well-regarded Tweedy Browne Global Value Fund and Longleaf Partners International now offer unhedged portfolios that invest heavily in non-dollar-denominated securities. Without any hedging against currency shifts, these funds can offer high returns if the dollar plunges—and get hammered if the greenback rebounds.

EMBRACING VOLATILITY

Other investors may want to take more preventive measures. Madalynn Matlock, portfolio manager of the Huntington International Equity Fund, avoids currencies she believes are heading for a fall, regardless of how much she likes a particular stock. Right now she's bypassing Brazil because of its recent steps to limit the strength of the real, including a 2% tax on foreign investments. Matlock also sees a rising dollar, at least in the near term. Since "everyone is betting against it," she says, a rebound is inevitable.

Some fund managers embrace volatility. The $23.3 billion Templeton Global Bond Fund, which is ranked in the top 5% in its category for three-, five-, and ten-year returns according to Morningstar, actively trades the currencies in its portfolio. That has helped it advance 18.3% in 2009.



MY FAVORITE INDICATOR

Daniel Fuss

Manager, Loomis Sayles Bond Fund

I am watching the condition of the money markets most carefully because they can change so quickly.

I look at the interest rates on eurodollars, Treasury bills, and particularly on commercial paper. [Commercial paper is unsecured debt issued by banks and other companies to finance their short-term credit needs.] A year ago, the commercial paper market was hardly open to anyone. Although commercial paper is primarily used by financial firms, the breadth and depth of that market is extremely important. The commercial paper markets will be the first place to look [to see] if interest rates are going up. *—as told to Lauren Young*

The Merk Hard Currency Fund trades in currencies, not stocks or bonds. It has outperformed 99% of currency funds over the past three years, with an annual total return of 7.3%. It has a large stake in the krone of Norway, a commodity-rich nation that "has all the advantages of being in Western Europe and none of the disadvantages," says fund manager Axel Merk.

Some exchange-traded funds mimic actively traded currency funds. One ETF, the PowerShares DB G10 Currency Harvest Fund, captures the momentum of currencies by buying those of countries with high interest rates. Generally these currencies go up. The fund also sells currencies of nations with low interest rates, since these currencies should fall. It has loaded up on Aussie dollars and Norwegian krone, while shorting the dollar and Swiss franc. The momentum strategy worked well in 2009, but not in 2008. The expected volatility in 2010 will make currency plays that much harder to execute. |BW|

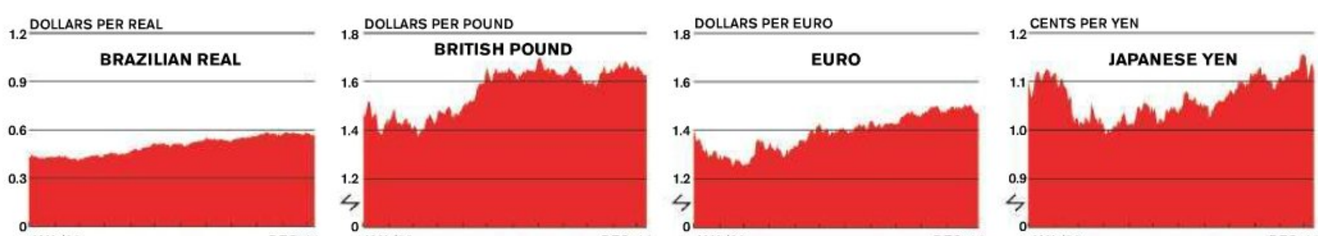
How Other Currencies Beat Up on the Dollar

Since peaking against the real in 2002, the dollar has lost more than half its value

The pound is now worth $1.63, slightly below its long-term average

The euro has risen from a low of $1.25 and trades at $1.47, 23.5% above its 10-year average

On Nov. 30 the dollar traded at a 14-year low to the yen



Data: Bloomberg

(FROM TOP) ANDY FRIEDMAN; CHART BY DAVID FOSTER

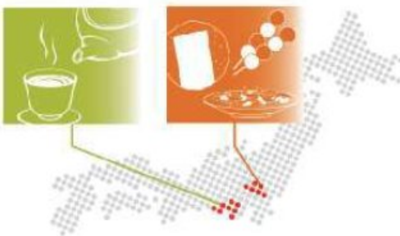
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Success Begins with Innovation

INVEST JAPAN

Japan Regional Initiative – Food Industry Saitama-Shizuoka: A Mouth-Watering Opportunity



As the world's second-largest economy and the home to a wealth of innovative ideas, Japan continues to attract attention from investors and firms looking for international partnerships. While most are familiar with the urban expanses of Tokyo, Japan's financial and administrative center, there are countless untapped opportunities waiting outside the city limits for insightful investors. Two locations that should definitely be looked into by anyone interested in Japan are the prefectures of Saitama, part of the Greater Tokyo Area, and Shizuoka to the south, part of the commercial area for the Nagoya-Osaka region. Together, these two prefectures are home to a large portion of Japan's food industry. This does not mean that they are rural farmland, however. On the contrary, Saitama and Shizuoka are on the cutting edge of the food industry, producing more prepared foods, beverages and finished meals for shipment throughout the country and overseas than any other region of Japan. Their central location, extensive highway and rail networks and numerous bullet train stations provide immediate access to Japan's major urban zones, making both prefectures ideal for companies interested in the business development potential of Japan's food industry.

Saitama: Cooking Up Japan's Meals

Much of Saitama is within 50km of the heart of Tokyo, making the capital city an easy commute for many residents. Saitama's local economy is equal in size to Finland's, and boasts food industry output of $14 billion, making it the third largest in Japan. Located at the heart of a logistics network linking Eastern Japan, Saitama provides fresh food for Tokyo and the surrounding prefectures, including fresh fruits and vegetables year-round for restaurants and supermarkets. Taking advantage of the region's close proximity to both farming and population centers, not to mention the high quality transportation network throughout the area, many food industry firms have established themselves here. Top-selling dishes range from traditional favorites that have been enjoyed for centuries, like rice crackers and sweet bean buns, to cakes and confectioneries that rival their western counterparts. Japan's affinity for technical innovation has reached the food industry as well, as processing centers in Saitama employ advanced technologies to ensure the highest levels of productivity, cost efficiency and, above all, quality. Food-related manufacturing companies can also be found in Saitama, providing products ranging from home-use food mixers, to professional-quality kitchen wares, all the way to industrial-scale automated machinery.

Sources:
Institute for International Trade and Investment
Saitama Prefectural Economic Report, 2006
METI, Industrial Statistics Report, 2007
Saitama Prefecture homepage


Traditional Japanese snacks produced in Saitama.

Shizuoka: Adding Function to Food

Located on the Pacific coast, Shizuoka's warm climate and fertile land have helped in making it a leading producer of fresh and prepared foods and beverages. The region enjoys many natural advantages, such as extremely pure spring water sources from Mt. Fuji and the Japan Alps, plus a location with easy access to Tokyo and Nagoya that have made it an ideal setting for industries of all varieties. In total, the food and beverage industry in Shizuoka is worth approximately $24.8 billion*, with more beverages being produced here than anywhere else in Japan. Fresh foods, such as fruits, vegetables and tea, are a particular source of local pride, and together with seafood they make up over $3.4 billion** worth of the prefecture's annual food production. But beyond their


Green tea fields growing in Shizuoka at the foot of Mt. Fuji.

value as fresh produce, they contribute to the realization of a richer, healthier lifestyle through their use as functional components in a wide variety of nutritional products. In Shizuoka, one may find many top-tier universities and research institutes working to create 'functional foods' that provide additional health benefits. Already, many new products have been developed and brought to market through the cooperative efforts of universities and private corporations.

* METI, Industrial Statistics Report, 2008
** Shizuoka Prefectural Ministry of Agriculture, Forests and Fisheries, Agricultural Output Report, 2006

Serving the World

The Japan Regional Initiative – Food Industry Saitama Shizuoka, a consortium of government agencies as well as industry and research groups from both prefectures, will be hosting an exhibition space at the upcoming Fancy Food Show in San Francisco, where ambitious food producers from around the world will be in attendance to display their best dishes. In addition to promoting the strength of Saitama's food processing industry and the scope of Shizuoka's food-related research capabilities to a worldwide audience, the group will be providing information on the ease and benefits of partnering with industries here, as well as on the many incentives available. Already there have been many successful pairings between firms in Saitama and Shizuoka and their counterparts overseas, and the group is looking to further these fruitful relationships.

N·A·S·F·T FANCY FOOD SHOW

Come learn more about Saitama and Shizuoka. We'll be waiting for you at our exhibit space at the Fancy Food Show, January 17-19, 2010 in San Francisco.

METI Ministry of Economy, Trade and Industry

JETRO Japan External Trade Organization

For more information, visit: **www.jetro.go.jp/en/invest/**

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THE CASE FOR COMMODITIES

They could be a smart inflation hedge in 2010. And some pros see a long-term bull market for oil, grain, and gold. *By Lewis Braham*

Oil, gold, corn, wheat—perhaps the most attractive thing about commodities is they seem so concrete. Investors know that a barrel of oil may be worth more or less at the end of the day, but it will never disappear. In an age when major financial institutions can go bust overnight, that holds a lot of appeal.

Since most commodities are priced in U.S. dollars, 2010 may be a good year to invest in them. That's because the Federal Reserve has kept interest rates close to zero and increased the money supply dramatically, a move some experts say will ultimately devalue the dollar and spark inflation. As the amount a dollar can purchase decreases, commodity prices rise in relative terms. "Inflation usually starts by the government printing too much money," says Victor Sperandeo, a commodities trader and developer of a commodities index called the S&P Commodity Trends Indicator (S&P CTI). "Never in its history has the U.S. printed more money. When inflation becomes visible, we will start to see stocks slow down and commodities accelerate."

Historically, commodities have proved a better short-term hedge against temporary inflationary shocks than a good long-term investment. "Commodities are cyclical," says Sperandeo. "Corn goes up and down in price. It doesn't only go up. If you held nothing but corn in your portfolio from 1930 on, you'd have only a 2% annualized return, compared to 9% for stocks." For this reason Sperandeo developed his S&P CTI index, which follows short-term trends in commodity futures, investing in those with positive trends over the past seven months while shorting, or betting against, those with negative trends. (The strategy isn't unique, but building an index product around it for individual investors is.) Because of this ability to hedge, the CTI was up 17.7% during 2008's market meltdown. The new Direxion Commodity Trends Strategy Fund tracks the index (table, page 80).

Yet some money managers say there is a case to be made for a long-term commodity bull market. "Historically, commodity prices have tended to decrease by 1% to 2% annually because of improvements in the technology used to harvest commodities," says Samuel Fraundorf, co-manager of the Wilmington Multi Manager Real



MY FAVORITE INDICATOR

Richard Kang

Chief Investment Officer, Emerging Global Advisors, a provider of exchange-traded funds

I watch Warren Buffett. The best new stock he could find in 2009 was Burlington Northern. Aside from that, he largely chose to add to positions—Nestlé, Exxon Mobil, Wells Fargo, and Wal-Mart Stores. He's still all about value. But since cash has a negative net return, he's had to deviate at times. He did in a big way when he invested in a Chinese battery manufacturer in 2008. That was all about growth. He hasn't become a growth manager, but it does signal that even Buffett deviates slightly.

—as told to Lauren Young

ANDY FRIEDMAN

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(TOP) PHOTOGRAPH BY AARON PACKARD/BLOOMBERG NEWS

South Dakota corn: Weak grain production outside the U.S. may boost prices

Asset Fund, a fund that invests in commodities, real estate stocks, and inflation-protected bonds. "But you have to juxtapose that with the fact that the world population continues to increase, and standards of living in emerging countries such as China and India continue to improve at rates much faster than the natural decline we've seen in commodity prices in the past. These countries have a voracious demand for commodities."

SUPPLY SHORTAGE

Couple increased demand with the fact that during the recent downturn capital wasn't available to develop the infrastructure to drill for more oil, dig more iron, or grow more corn, and you see how a supply shortage could occur when the economy recovers. Figuring out where the shortages will be is the main challenge. "We're focusing on commodities where the ability to increase supply has been difficult—oil, copper, iron ore, and coal," says Jerry Jordan of the Jordan Opportunity Fund, which has beaten 99% of its fund peers in the past three years largely thanks to a 25% exposure in commodities.

Jordan says copper stocks have rallied too hard of late and are now overvalued, but he is still a big fan of oil. He likes offshore drillers Transocean and Diamond Offshore Drilling. "If you want to find more oil in the next decade, it will have to come from offshore drilling, and these companies are trading at ridiculously cheap levels relative to the value of their assets," he says. "Transocean trades at about seven times forward earnings and is an 83 stock. I think it will be worth 200 by the time the oil rally is over."

Ups and Downs

ANNUAL PERCENTAGE CHANGE*

	WORST YEAR		AVERAGE		BEST YEAR
GOLD	'97	-21%	7%	31%	'07
SILVER	'08	-23%	10%	53%	'09**
CORN	'96	-29%	5%	73%	'06
WHEAT	'96	-23%	6%	56%	'07
CRUDE OIL	'08	-54%	6%	112%	'99
NATURAL GAS	'01	-74%	6%	320%	'00

Data: Bloomberg *Since 1990 **Through Dec. 14

Jordan also thinks grains will experience a sharp upswing in 2010. "Outside the U.S. the rest of the world is having a terrible time producing enough grains," he says. "Farmers haven't put down enough fertilizer because the cost of fertilizer has become expensive. But you can only go so long without putting nutrients in the ground before grain yields are less. At the same time there is a rising demand for meat in emerging markets, and the amount of arable land and water resources is declining."

Rather than buy agricultural stocks, Jordan owns a 5% position in the PowerShares DB Agriculture exchange-traded fund (ETF), which

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holds futures contracts that track the price of wheat, corn, soy, sugar, cattle, and hogs directly. "If you want to play agriculture, there are few ways to play it in a stock-specific way," he says. Such futures-oriented ETFs are increasingly popular with investors.

Many ETFs that track individual commodities such as oil or natural gas can be volatile. Because of this, Wilmington's Fraundorf prefers ETFs with diversified baskets of commodity futures. "We've looked at how baskets of commodities have performed over time and found them to be a much better hedge against inflation than any individual commodity," he says. Currently his fund has a 33% position in the PowerShares DB Commodity Index ETF, a broadly diversified fund.

How to Play Commodities

Don't. The best way to take advantage of moves in the commodity markets is through professionally managed funds like the ones below.

Fund Name/TICKER	3-Year Return*	Expense Ratio**
Direxion Commodity Trends Strategy Investor/DXCTX	NA	2.00%
First Eagle Gold Fund/SGGDX	15.13%	1.21
Jordan Opportunity Fund/JORDX	3.00	1.41
Powershares DB Agriculture/DBA	NA	0.75
Powershares DB Commodity Index/DBC	0.02	0.83
SPDR Gold Shares/GLD	21.07	0.40
Wilmington Multi Manager Real Asset Fund A/WMMRX	-1.01	1.07
WorldCommodity Fund/WCOMX	-5.34	1.60

Data: Morningstar, Lipper; as of Dec. 14
*Annualized returns include reinvestment of dividends and capital gains; DXCTX and DBA do not have three-year returns ** Fees and expenses as a percentage of the fund's total assets

GOING WITH GOLD

If the dollar declines sharply, the best investment may be gold. "Gold prices aren't based on supply and demand like other commodities," says commodities trader Sperandeo. "They're based on people's desire to run away from paper currency into hard assets." He thinks price moves in other commodities may be correlated with the stock market in the short term, until inflation hits. Right now he's bearish on stocks. So Sperandeo prefers the SPDR Gold Shares ETF, which owns gold bullion directly, to investments in other commodities.

Gold stocks may not be as safe as bullion, since mining companies face special geopolitical and financial risks. But it is precisely the fear of such risks that often makes them attractively valued. "South African stocks such as Gold Fields, Harmony Gold Mining, and AngloGold Ashanti continue to be somewhat overlooked because of their perceived geopolitical risk," says portfolio manager Rachel Benepe of First Eagle Gold Fund. "But South Africa has a 25% unemployment rate, and the mining companies are its largest employer. The country can't afford to take the risk of hurting that business."

Other, less popular commodities may also present opportunities. Cotton declined for many years only to begin to recover recently along with the price of oil. "Cotton's primary competition is polyester," says Jim Llewellyn, manager of the WorldCommodity Fund. "Since polyester is made from oil, as oil prices rise it becomes less compelling compared with cotton." Llewellyn's favorite in the sector is J.G. Boswell, "the largest cotton grower and one of the best-run farming operations in the world," he says. The company has a not-so-well-hidden asset in the vast quantities of water on its property in California's San Joaquin Valley. Its stock, however, is not very liquid, since the company is closely held by the Boswell family, which doesn't trade its shares much.

Llewellyn is also a fan of natural gas. He likes it as an energy play but also because it is a primary ingredient in fertilizer. "I have a strong view that there will be a shortage of fertilizer in the next 36 months," he says. He favors Canadian gas players such as Birchcliff Energy. As for investors playing these volatile commodities directly via futures, Llewellyn agrees that is best left to the pros. | BW |



ANDY FRIEDMAN

MY FAVORITE INDICATOR

John W. Rogers Jr.

CEO, Ariel Investments

We have expanded the areas we watch for early signs of debt problems. We are now actively monitoring the credit default swap, leveraged loan, and bond markets. Prices in these markets are available in real time from many places, including Bloomberg. (*BusinessWeek* is owned by Bloomberg LP.) We translate prices in these other markets to create implied credit ratings that might be different from the official rating issued by agencies like Moody's Investors Service and Standard & Poor's.

During the economic crisis we often found that these markets were ahead of the rating agencies—and even the stock market—in seeing signs of credit trouble. For example, the credit default swap market could be pricing $10 million of default insurance on Company A at $250,000. Our analysis might show the company's implied credit rating at B3 even if Moody's gives it a higher rating at Baa3. The idea is to monitor multiple sources of information for early warning signals. *–as told to Lauren Young*

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HEDGE YOUR BETS LIKE THE BIG BOYS

More private equity and hedge-fund-like products are being aimed at individual investors. Is that a good thing? *By Tara Kalwarski*

Institutional investors have long used private equity and hedge funds to achieve overall returns far higher than those eked out by individuals. In the 10 years ended Dec. 31, 2008, Hedge Fund Research's Fund Weighted Composite Index gained 7% per year, on average, while the Thomson Reuters U.S. Private Equity Performance Index returned an annual average of 17%. That compares with a 13% cumulative loss for the Standard & Poor's 500-stock index.

Until recently the masses lacked easy access to these asset classes. Over the past year, however, the number of products that offer individual investors ways to invest in alternative assets has swelled. Should individuals jump in now that they have the chance?

Alternative investment vehicles weren't immune to 2008's market crisis: A record-setting 1,471 hedge funds closed in 2008, and 858 shut their doors in the first three quarters of 2009. Total assets shrank by more than $300 billion, to $1.5 trillion, according to Chicago-based Hedge Fund Research. And private equity funds raised $187 billion through Sept. 30, 2009, significantly less than the $478 billion collected in the same period a year earlier, according to London-based researcher Preqin.

Rob Kaimowitz, CEO of Bull Path Capital Management in New York, converted his hedge fund into a mutual fund, the Bull Path Long Short, in early 2009 after seeing what he describes as a huge opportunity in the retail space. Most investors, he says, only own "long" funds, or those consisting of stocks the managers think will go up. Kaimowitz's fund uses a long-short strategy. "We pick the stocks we think will go up and the stocks we believe will go down, which manages risk because you limit your overall market exposure," he says. "If the market goes down, you're capturing part of that."

In addition to short positions, long-short funds can also use leverage and derivatives. Morningstar tracks 78 such funds, about a fifth of which were launched since the crisis began. Only three earn the coveted five-star rating: Robeco Long/Short Equity, which in 2009 had gained 78% as of Dec. 14; TFS Market Neutral, up 17%; and Wegener Adaptive Growth, up 39%.

RAISING THE ANTE

Hedge funds lost an average 19% in 2008. But the global downturn actually increased institutional investors' appetites for alternatives. According to a survey by Greenwich Associates in June 2009, about a fifth of institutions polled said that despite losses, they plan to increase allocations to hedge funds and private equity. That's because alternative investments can not only enhance overall return, they also reduce portfolio risk, according to Massachusetts Institute of Technology finance professor Andrew W. Lo, who also manages his own fund. The 2008 decline in hedge funds was much less steep than the S&P 500's 37% drop, and though hedge fund performance lagged behind U.S. equities in 2009, the asset class has bested the S&P 500 by 18 percentage points since the end of 2007.

"Financial markets have gotten quite a bit

WESLEY BEDROSIAN

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attributes the fund's outperformance to its go-anywhere style. "We're constantly scouring the globe for new listings." Broad geographic, industry, and market cap diversification, he says, is a must. But so is buying at the right time. Management began adding Blackstone to the portfolio in early 2009, when shares were trading below 5. Now, at 14, "it's one of the top holdings," says Samson.

Darek Wojnar, head of product strategy and research at iShares, thinks the business of alternative assets is "in its adolescence." As retail products proliferate, the asset class will become more user-friendly compared with the hedge funds of old, he says: "Why would investors want to invest in vehicles that are expensive, have no transparency, have significant liquidity restrictions, and do not disclose exposure?"

Already, JPMorgan, and Schwab are among the big shops offering retail funds. Exchange-traded funds have also popped up, such as iShares Diversified Alternatives Trust, which has an expense ratio, or the annual cost to investors expressed as a percentage of the total amount they have invested, of 0.95%. A newer player in the fund field, IndexIQ in Rye Brook, N.Y., offers two ETFs that use hedge fund strategies, both priced at 0.75%. But don't be persuaded by the low fees alone. Lo warns that some ETFs use short positions and are "potentially misleading," because they offer short exposure on a daily basis rather than over a period of time. Check with a financial adviser or fund ratings service before buying. |BW|

more complex over the last couple of decades," says Lo. "It's not possible to get diversification through long-only investments." He suggests investors avoid alternative funds that chase performance and choose those that use hedge fund strategies that lower risk. Lo's Natixis ASG Global Alternatives Fund is up 5% since launching on Sept. 30, 2008.

Private equity plays for small fry investors are more limited. Individual investors who want in can consider a number of private equity firms that trade publicly, including Blackstone Group and Onex. But because single-stock bets are risky—Blackstone is down 56% since its June 2007 IPO—investors looking for exposure should probably stick to funds that track listed private equity firms. An ETF from PowerShares, the Global Listed Private Equity Portfolio, as of Dec. 14 had returned 30% in 2009. Vista Listed Private Equity Plus, an active mutual fund, was up 42%. Steven R. Samson, president of Vista Research & Management in Greenwich, Conn.,

Taking the Long-Short View

These long-short mutual funds are among the cheapest in the category. Morningstar has given each ratings of three stars or better, out of five.

Name/TICKER	Expense Ratio	Total Return* 1 Year	3 Years	5 Years
Calamos Market Neutral Income/CVSIX	1.12%	16.0%	1.3%	2.1%
Gateway/ GATEX	0.94	10.2	-0.3	2.7
GMO Alpha Only III/ GGHEX	0.23	-7.4	3.9	4.0
Hussman Strategic Growth/HSGFX	1.09	4.1	-0.2	1.8
JPMorgan Market Neutral/ JPMNX	1.01	11.4	5.6	4.7

*As of Dec. 14; multiyear returns are annualized

Data: Bloomberg, Morningstar

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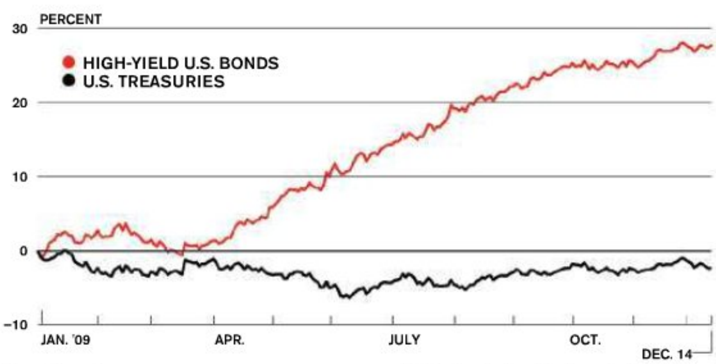
A LOOK BACK AT OUR 2009 HITS AND MISSES

The advice we gave investors a year ago was largely on the money—with a few exceptions. *By Roben Farzad and Tara Kalwarski*

A main focus of last year's Investment Outlook was how to profit from the panic by snapping up underpriced assets that others had abandoned. While it took some patience (the market hit bottom in mid-March), investors who adopted that approach and hunted for value did very well, as the markets had their best showing in years. Here's a look, as of Dec. 14, at where we were on the mark—and where we went wrong.

Junk Jumped

A year ago we noted that a diversified portfolio of U.S. junk bonds yielding more than 20% a year was a chance to "double your money in less than four years." An index of high-yield bonds (below) returned 28%.



Data: Bloomberg

*Calculated using Barclays Capital indexes

Wrong on Energy, Right on China

WHAT WE SAID	THE REALITY
The energy sector is ripe for a rebound, with oil prices less than one-third their July peak.	Even with the snapback in crude prices, the 9.8% return for energy companies in the S&P 500 was less than the overall index's 23.3% gain.
Verenium, a waste-to-ethanol player, will be among the clean-tech companies likely to survive the recession.	The stock plunged 58.3%, dragging our four-stock cleantech portfolio into the red.
Give stocks from Brazil, Russia, India, and China (the BRIC countries) a second look. Nigeria, meanwhile, looks promising.	An iShares exchange-traded fund that tracks a BRIC index gained 85.6%, but Nigeria's stock exchange dropped 34%.

Eggheads Gone Awry

The economists in our 2009 survey predicted...

The economy would fall by **0.2%**

Unemployment would peak at **8.1%**

Consumer price inflation would hit **1.2%**

Actually...

The economy fell **2.5%**

Unemployment hit **10.2%**

Consumer price inflation was .... **-0.3%**

Reliable Returns

We called Coca-Cola, Dow Chemical, Hewlett-Packard, Schering-Plough, and Tesco "comfort stocks." If you'd invested $2,000 in each, you'd be up 69.6%.



*Assumes Schering-Plough investors held on to shares following the merger with Merck

Data: Bloomberg

CHARTS BY DAVID FOSTER/BW

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THE KYRGYZ REPUBLIC LOOKS AHEAD

A stable environment and a multi-ethnic society provide new opportunities for foreign investors in Central Asia.

Located strategically in Central Asia, the Kyrgyz Republic is signaling that it's serious about boosting its standing in the investment world.

As nations compete to attract the attention of investors, one indicator shows that this country of five million people is headed in the right direction: The Kyrgyz Republic has jumped from 99th to 41st place in the World Bank's 2009 ease of doing business ranking, making it better than 75% of all countries. For getting credit, it is also in the top ten percent. For protecting investors, it is the 12th best country in the world. These are huge advantages.

The bullish sentiment is echoed around the capital Bishkek, where business leaders – both local and foreign – talk about an improvement in business sentiment.

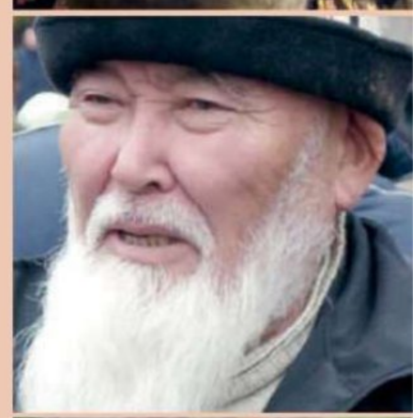
Speaking at the Bishkek International Banking Conference recently, former US Senator Donald Riegle said the Kyrgyz Republic had already demonstrated some surprising strengths in the face of the global financial crisis. "In this difficult year of 2009, as the world reeled from the collapse of securities markets and major global financial institutions, the Kyrgyz Republic stayed steady, moved ahead with some important reforms, and held its footing despite real challenges."

The European Bank of Reconstruction and Development in June allocated US$70 million for loans aimed at providing funds for entrepreneurs to develop small and medium sized enterprises. The move was praised by foreign commentators who said it would give the country's burgeoning private sector a hand up.

The government has also made some bold moves to cut taxes. Value-added tax has been reduced from 20% to 12%, and the overall number of taxes reduced from 16 to 8.



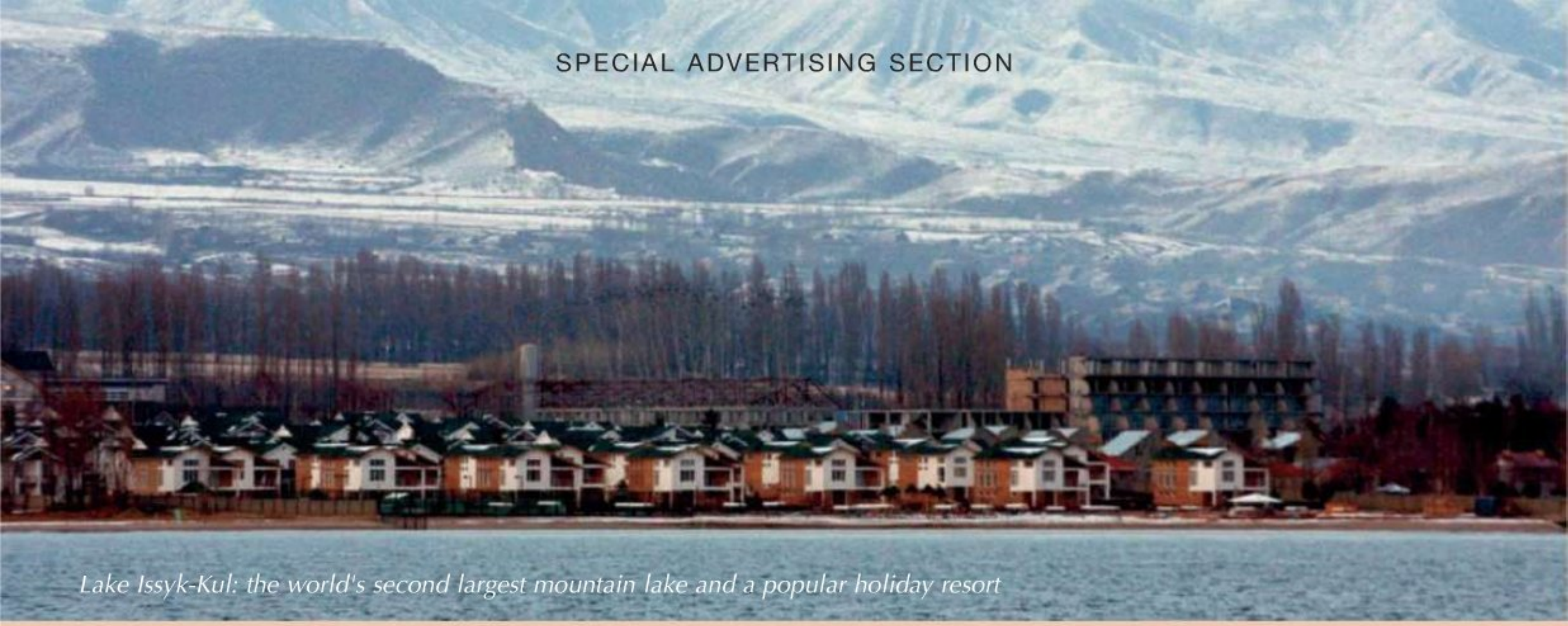








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Lake Issyk-Kul: the world's second largest mountain lake and a popular holiday resort

There is still a lot of work to do. Real GDP growth slowed to 0.3% in the first half of 2009, due to a slowdown in industrial production and the retail trade and the wider effects of the crisis.

The country did however narrowly avoid recession by continued buoyancy in fixed investment and construction.

Exports fell 13% year-on-year in the first half, but imports dropped more, by 25%, narrowing the trade deficit to US$783 million, compared to US$1.2 billion a year earlier.

While analysts said gold output was disappointing in the first half of 2009, the signing of a major agreement with Canadian miner Centerra has provided a much needed boost to the confidence of foreign investors.

The Kyrgyz Republic is a mountainous country, and has rich resources of gold, copper, and uranium that will provide wealth to future generations if developed properly, says Ilyas Davydov, Minister of Energy. He says the government is currently seeking investments to develop the country's sizable coal resources.



Davydov is also keen to see further development of hydro resources, using the Norwegian experience in hydro-energy resources as an example. "Each year, our hydro-electric plants produce 10-12 billion kW of electric energy, however we could produce up to 150 billion kW, and we could provide electro energy and water resources to neighboring countries."

In his recent inauguration, President Kurmanbek Bakiyev said his goal was to ensure political and civil security as a prerequisite for economic development. Without it, the Kyrgyz Republic will not be able to realize its potential. Stability has always the priority for political leaders in the region as they sought to shape a national identity following the collapse of the Soviet Union.

While Central Asia has historically been prone to conflicts, President Bakiyev says he plans to continue a process of integration into the world community, strengthen bonds with neighbors in the region and provide a stable platform for foreign investors. ■

THE DEVELOPMENT FUND: WEALTH FOR FUTURE GENERATIONS



Alexey Eliseev

The Kyrgyz Republic has launched a national development fund to improve and stimulate investment in strategic priority sectors of the economy.

It's part of a bold new strategy to boost corporate governance and work closely with foreign and domestic investors to improve capitalization. Headed by lawyer Alexey Eliseev, the fund aims to stimulate the government's priority sectors of energy, industry, agriculture and tourism.

"We have considered experiences and best practices of other funds, and integrated them into our own work," says Eliseev. "We don't want to get involved with projects that don't meet our strict risk criteria. We want to become an ally and instrument for private business and not their 'big brother' that interferes in business affairs."

The fund will finance national projects (direct debt and shared) and projects through authorized banks (including regional programs). It will invest by participating in partnership with private investors and financial institutions (PPP), including: micro credit companies to finance agriculture projects, mortgage companies, Islamic financial institutions and leasing companies. The fund will also manage joint funds, government bonds and debt. Local investment bank MGN Group has been appointed the financial advisor and asset manager for the US$286.3 million fund.

"We would like to invite the potential international investment community and existing partners along with us to invest into the economy of the Kyrgyz Republic and create partnerships, co-finance on equitable basis and we will share the risks and rewards equally. We want to serve as a catalyst to improve the business environment that is more and more investor friendly," says Eliseev.

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AUB: BANKING ON GROWTH

Mikhail Nadel

The ages-old paradox of whether the glass is half-empty or half-full is not even a question for entrepreneur and investor Mikhail Nadel, chairman of the board of Kyrgyzstan's AsiaUniversalBank (AUB).

"I always see potential," says Nadel, and in the case of the Kyrgyz Republic he believes the opportunities are huge.

"Just look around and you can see the impact of the global financial crisis everywhere in the world. But here, all sectors of the economy are still growing and overall productivity is among the highest in Central Asia. The country's business environment is very friendly – there is strong and comprehensive banking regulation in place, tax rates are low and construction and labor costs are relatively inexpensive – and because the economy is still in the early stages of development, investors who come here have a great opportunity to create very profitable businesses."

And when they come, Nadel intends for AUB to be there to assist them. The chairman of Kyrgyzstan's largest bank believes that investors should look to leverage the country's geographic position and its ability to facilitate the development of commercial relations between the emerging markets of Central Asia and the rest of the world.

"Our goal is to be a long-term, reliable strategic partner for our clients – basically we aim to make it easier to do business in Central Asia."

It is AUB's philosophy of integrity, transparency, excellent customer service and innovation that Nadel believes will enable it to achieve its ambitious goals.

"When we founded AUB in 1997, it was basically a local bank with a small presence in Bishkek. Today AUB has grown into the biggest bank in the country in all terms, and also has the largest network of international correspondents."

In July 2009, AUB was recognized for the fourth time by Euromoney magazine as the 'Leader in Corporate Governance in Kyrgyzstan', and the bank has also tapped into an international talent pool, with board members including two former US senators (R. Dole and B. Johnston), and a 25 years veteran of the International Monetary Fund (M. Mered).

"There are 22 commercial banks for a population of around five million and only 4-5% of the population actively utilizes the banking system. That means there are 22 banks competing for roughly 250,000 individual customers. The only way to not only survive, but to thrive in that kind of environment, is to be consistently the best. We also recently completed a very successful share capital increase, and we are now the best capitalized bank in the Kyrgyz Republic."

Operating in such a small and developing market does not come without obstacles, but Nadel sees the opportunities those challenges provide for AUB.

"While there is plenty of scope for further growth, particularly as we penetrate deeper into the retail segment, there is no question that the Kyrgyz banking sector is becoming increasingly competitive. In the near future we should see more consolidation – but AUB is no stranger to growth through consolidation (we recently absorbed former Kyrgyzpromstroybank), and ultimately we think it will help strengthen the overall system and improve the local banks' access to international capital."

Asked where he sees the brightest opportunities in Kyrgyzstan, Nadel cites manufacturing. "It is already a very interesting sector and will become more so in the near future when the hydro-electric power plant projects in the south of the country are completed. The price of electricity will be lower here than in the neighboring countries, and that will help make Kyrgyzstan an even more attractive destination."

Does Nadel believe these developments will create more opportunities for AUB?

"Of course it will," he says with his characteristic optimism. "AUB's role is to be a trusted partner facilitating international trade and commercial activities in the heart of Central Asia."

AUB

www.aub.com

CONFIDENCE IN TROUBLED TIMES

The Kyrgyz Republic has a small economy and is very sensitive to external changes, says Marat Alapaev, governor of the country's central bank. Alapaev explains that when the first shock waves of the global financial crisis were felt he knew preventative measures had to be taken, and fast.

The bank started by creating a refinance fund for the banking system. This provided some psychological support, boosting confidence in the bank's ability to protect personal deposits. Built into the legislation is a last resort clause that allows the bank to increase the liquidity if necessary.

"The fund became an easily accessible tool to respond to liquidity problems. It enabled us to influence rates on credit in commercial banks," says Alapaev.

"We have seen from the experience of other countries that providing direct resources to commercial banks does not work effectively in the long run as they put pressure on the exchange rates. We have linked the funds to the reinvestment fund to the credit portfolio of the commercial banks. So if a commercial bank applies for reinvestment funds then they have to increase their credit portfolio by the same amount."

The Central Bank has also increased the warranted amount of reinsurance, which can cover more than 90% of individual deposits.

"We are quite sure that we have overcome the first shocks and we believe that the commercial banks are to a certain extend sound," confirms the governor. Eugene Gourevitch, the CEO of investment bank MGN Group, agrees: "The system has also been made a lot more stable by the establishment of the agency for deposit insurance as well as a fund for banking and financing, and as a result, a number of new banks have come into the country, even since 2004." The total assets of the banking sector have grown by 30% since 2006, deposits by 24%, and total credit portfolio by annual factor of 34%."

While ensuring stability in the banking sector has been the immediate priority, transforming the Kyrgyz Republic from a "dead-end country" into a transit-zone country is the next step of the plan, says Minister of Finance Marat Sultanov. "Until recently we have been a blind country,

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MGN: LOCAL SUCCESS, GLOBAL AMBITIONS

Eugene Gourevitch

MGN Group is the first international investment bank in the Kyrgyz Republic to offer the full range of investment banking services. The company has offices in London, New York, Moscow and Bishkek, and runs across three business lines.

MGN Capital is essentially engaged in corporate finance, mergers and acquisitions and research services. The other two lines are MGN Asset Management, and MGN Capital Partners, which invest directly into the economy. Currently the MGN Group manages about US$200 million – a tidy sum considering the size and level of development of the country.

For CEO Eugene Gourevitch, the Kyrgyz Republic is an ideal base because investors are realizing that higher returns will continue to be generated in frontier and developing markets. He says the Kyrgyz Republic's business environment is more business friendly compared to its neighbors. MGN's strategy is to offer international best practices combined with local knowhow. It also plans to work closely with local companies to boost standards and continues to cooperate with the Central Asian Stock Exchange. (MGN is a 50% stakeholder in the bourse).

"We realize that, as opposed to working in developed markets, where you have companies used to corporate governance standards, to transparency initiatives, a functioning board that interacts with management, it is not really the case here. So, one of our first jobs is to explain to the companies that all these aspects are critical in working with investors and to relate that confidence to investors. We have an educational role."

Despite the fallout from the global financial crisis, the bank is off to a flying start. It was recently awarded the tenders to work as financial advisor and asset manager for the government's new Development Fund. Gourevitch is thrilled about the unique prospects of the Kyrgyz market.

"What's really interesting here is that you essentially have most of the financing through equity or through debt, just borrowing from the banks. You don't have any international bond offerings so far, they have very limited activity in local bond markets and even banking penetration is very low. It creates an interesting situation for future growth. The whole region is very compelling, and if you look at it there are probably very few regional platforms which provide the same level of growth as the Kyrgyz Republic. We invite you to work with MGN group to actually find interesting opportunities and to structure those investments." Gourevitch has bigger plans for the MGN Group and he is keeping his eyes open for new opportunities in the region and further afield.

M-G-N

www.mngroup.kg

where we didn't have China to work with so we mainly looked to Kazakhstan, Uzbekistan and Russia, and we did not have roads going further. That was the situation when we just became independent."

The country soon realized it could leverage the trading relationships in the region but it needed to build the lifeblood of trade in this part of the world: roads.

'The Great Silk Road' strategy has seen the building of two corridors, one in the south and another in the north. The next stage of the strategy is to build a railroad which will further act as a conduit for international trade. Airport upgrades and construction are also a priority, says Sultanov. He says there will be continuing opportunities for foreign investors to participate in ongoing infrastructure projects.

The minister also sees financial sector development as a key part of the country's plan to revitalize its trading credentials. "We have one of the most liberal currency regulations and exchange rates. Regional banks, including a number from Kazakhstan have shown interest in opening branches here and this will provide benefits for the Kyrgyz Republic." ■



Opera house in Bishkek

CASE: BRINGING BUSINESS TO THE BOURSE

Success for a stock exchange is measured in trading volume and so Altynbek Alymkulov, president of the Central Asian Stock Exchange, has reason to be pleased.

Out of the three exchanges operating in the Kyrgyz Republic, CASE has recently achieved the highest volume and continues to attract high quality listings. Most of CASE's listed companies are blue chips of the Kyrgyz Republic.

The smooth running of a stock exchange also relies on on infrastructure. The bourse is investing in the most sophisticated IT and telecommunications infrastructure, says Alymkulov.

"We have just completed development and we are now implementing a software system that can handle fully automated trading, depositary and clearing transactions."

Alymkulov explains that part of CASE's strategy is to contribute to the development of the capital markets in the country and help bring new products to the investment market. "One of our strategic initiatives is to trade in state securities. The government has announced a tender to select a stock exchange that will serve as the platform and we are hoping to win it."

CASE is also looking for foreign partners who can bring technical expertise and assistance to further assist in the development of the exchange.

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Owned by Canada's Centerra Gold, the Kumtor mine has produced more than six million ounces of gold between 1997 and 2007.

FOREIGN INVESTORS RIDING RESOURCES WAVE

Foreign mining companies operating in the Kyrgyz Republic have reason to express renewed confidence after a number of breakthroughs that show the government is serious about business.

Canadian miner Centerra Gold is the highest profile company working in the country and has reached an agreement with the government over the Kumtor mine after a lengthy negotiation.

The Kumtor mine is the largest gold mine operated in Central Asia by a Western-based company, with 2008 gold production exceeding 556,000 ounces.

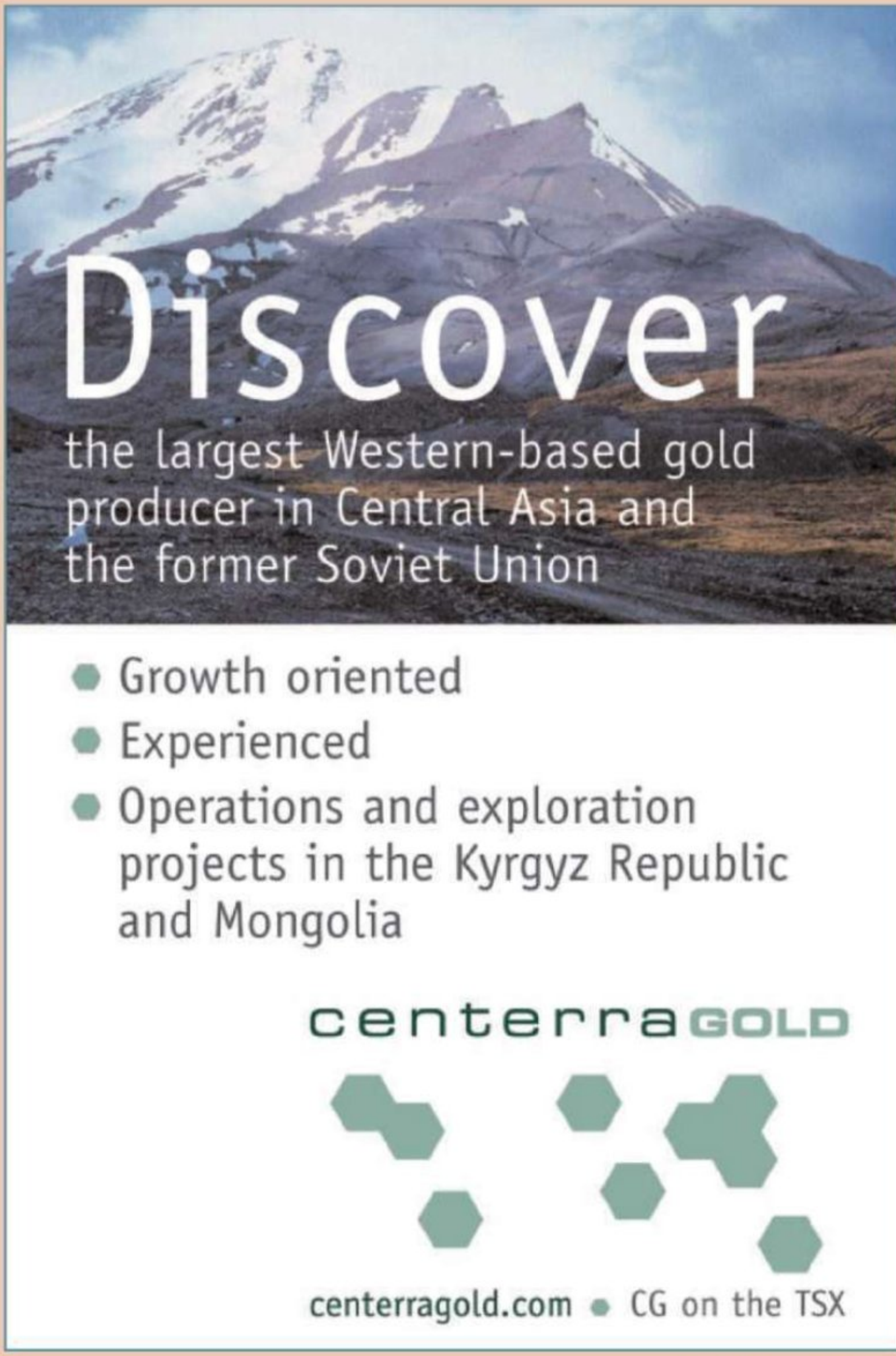


Robert Wunder

The government has taken a 'hands-off' approach to the mining sector, says Valery Tutykhin, advisor to the director of the former State Agency of Geology and Mineral Resources (now Ministry of Natural Resources) and partner at John Tiner & Partners law firm. Tutykhin helped the agency draft new mining legislation.

"The new legislation on mining is unique in that it leaves only a few strings in the hands of the government to control the fate of the mining licenses. In most developing nations we see the opposite: nothing is automatic, you have to deal with bureaucracy," explains Tutykhin.

"It will definitely be welcomed by mining investors who want a more legally secure environment for their activities. Coupled with very liberal tax law, almost non-existent exchange controls and the right to directly export own mineral produce, this legislation should boost the country's bid for mineral



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Bishkek, the capital of the Kyrgyz Republic, is one of the greenest cities in the world

investment from abroad," affirms Tutykhin.

Newly appointed Minister of Natural Resources Kapar Kurmanaliev echoes the sentiment: "In no way can the government expropriate an investor. They are protected if they respect our legislation. Licenses can be taken away or suspended only if the company is not working honestly or if the environmental law is not respected or it doesn't pay its taxes – and this will be through our judicial system."

Centerra's investment in the Kyrgyz Republic is already more than US$ 1 billion, according to Robert Wunder, president of the Kumtor gold operation, which is 100% owned by Centerra.

"We have also paid back into the country the equivalent of nearly US$1 billion over the past 10 years in taxes, wages and benefits paid to the employees."

Kumtor gold mine began production in 1997, and has produced more than 213 tons of gold. The mine is a large, complex mining operation, located 4,000m above sea level.

Wunder reckons in terms of safety and environment, the Kumtor mine is "without question the safest and most environmentally responsible business in the Kyrgyz Republic and in Central Asia."



Downtown Bishkek

The operation employs more than 2,500 people, of which less than 5% are expatriates. "The Kyrgyz people are interested in working, they are good workers and quite well educated. We have a very challenging operating environment at the mine site. We have invested substantially in training our workforce since the beginning of our operation," he says.

Wunder believes foreign companies need to give back to the community if they want to be successful in a place like the Kyrgyz Republic.

"Our focus on the needs of Issyk-Kul province and support for the sustainable development of the region sees us contribute 1% of proceeds from gold sales to the Issyk-Kul Development Fund. These resources, amounting to nearly US$5 million per year, will be used to improve infrastructure, build new schools and support viable business projects that will help provide business and job opportunities."

Kumtor also continues to support a regional development program developed by the company that has, over the past three years, helped renovate a number of schools and libraries, rural health and cultural centers. ■



Vugar Khalilov

FLEXI COMMUNICATIONS: GETTING THE MESSAGE OUT

There's a big gap in the market for full service communications, according to public relations and media specialist Vugar Khalilov, who launched Flexi Communications to offer PR services to companies in the Kyrgyz Republic and wider afield.

"We found that our market is the whole of Central Asia since even in big markets like Kazakhstan, the communications business is still very young," says Khalilov. "There was a misunderstanding of basic communications practice, and more importantly, very little appreciation of how communications and public relations fits into a company's business plan."

A UK citizen, Khalilov says his solid background in the Western media and PR industries are put to good use at Flexi Communications. "I bring in my overseas experience and combine that with my team's broad knowledge of the local and regional market." This approach allows Flexi Communications to provide local and international companies in Kyrgyzstan and the wider Central Asia region with 'international standard' corporate financial communications, marketing, market regulators relations and special events planning.

He says he continues to work with local companies to help them understand the importance of keeping an impeccable reputation and the significance of publicity in raising financing.

FC Flexi Communications

www.flexicommunications.com

TSP: PRODUCING FOR THE WORLD

Tash-Kumyr Silicon Productions – TSP – opened a new factory in July 2009 manufacturing polysilicon, the basic material for production of solar cell panels, electronic devices and systems.

When President Kurmanbek Bakiyev visited the plant, located in the city of Tash-Kumyr in the country's west, he said the start of production gave the Kyrgyz Republic "a chance to become a noticeable player in the world market for silicon products." Demand is constantly growing, and production is only possible is a few countries, including the Kyrgyz Republic. The president noted that it was essential to develop the company's capabilities to include finished products in a bid to significantly increase profitability.

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Santas of world unite: The Kyrgyz Republic's location provides logistical efficiency

THE MOST EFFICIENT LOCATION FOR SANTA'S BASE

Number crunchers at Sweco Consulting say taking into account Earth's rotation, the Kyrgyz Republic would provide the best location from which to deliver gifts to the world's 2.5 billion households because it would avoid time wasting detours. But even if Santa uses the Kyrgyz Republic as his starting point, he still has his work cut out for him – his reindeer would need to travel at 5,800km per second and spend only 34 microseconds on each chimney stop to complete all deliveries. ■

MC: Connecting You to the Kyrgyz Republic!

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MC is the leading travel and tour agency in the Kyrgyz Republic. We offer airline ticket arrangements, individual as well as group tours, nature and camping visits, hotel bookings, mobile phone rentals, as well as a host of other travel related services. Experience the hospitality of the Kyrgyz people, the charm of the Tien Shen mountains, and the majesty of Lake Issyk Kul.







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The Kyrgyz Republic
Beauty - Nature - Serenity

GETTING CONNECTED

The telecommunications sector in the Kyrgyz Republic is one of the most dynamically developing areas of economy.

Driving the growth is the fast expansion of the mobile market. Rapid growth in subscriber numbers has been accompanied by steady reductions in prices and increases in regional network coverage.

There's still plenty of room for growth. While developed countries are reaching saturation point in the mobile market, the level of penetration of mobile in the country was about 50% in the middle of 2008. Fixed line penetration sat at around 10%.

The government's privatization of OJSC Kyrgyztelecom is intended to ensure higher rates of development of wire and wireless fixed telecommunications to meet the existing demand for basic telephone services, and also additional services of internet access, data transfer, intellectual networks and other services that are provided by the possibilities of modern telecommunication networks. ■

KYRGYZTELECOM
open joint stock company

OJSC «Kyrgyztelecom» provides its customers with following kinds of services:

- ITC (International Transit Circuit service)
- IDD (International Direct Dial service)
- Local calls service/Long Distance calls service
- Internet Access service
- VPN
- IPLC (International Private Leased Circuit)
- NPLC (National Private Leased Circuit)

http://www.kt.kg

MEGACOM: LEADING THE WAY

MegaCom is the most dynamically growing mobile operator in the Kyrgyz Republic, providing services in standard GSM 900/1800.

Having launched a little over three years ago, the company is now a market leader in the telecommunications sector in Central Asia.

Revenue grew by a staggering 815% in 2007 and 233% in 2008, and as a result, the company has become one of the ten biggest taxpayers in the Kyrgyz Republic. Its mobile coverage now reaches 90% of populated territory across the country.

New subscribers have been driving MegaCom's financial growth. By the end of 2006, following an April launch, the company had attracted 153,000 subscribers. Growth really took off in 2007 and 2008 with 572,000 and 1.13 million subscribers, respectively. Even in 2009, the company continued to post robust numbers with 45% growth between January and October and its customer base topping 1.7 million.

Today MegaCom enjoys a 37% market share in the Kyrgyz Republic, thanks in part to its products being available at more than 7,000 points of sale.

The company is considered a leader in innovation and is the first mobile operator in the Kyrgyz Republic to be awarded ISO 9001:2000 quality management certification.

MegaCom's services provide customers the best combination of price and quality, a superior range of services, reliable communications and transparent charging.

MEGACOM
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STRATEGY & COMPETITION

Why Facebook Wants Your ID

By trying to be the de facto standard for online identity, it's making privacy advocates nervous

By Douglas MacMillan

On the walls of Facebook's Palo Alto (Calif.) headquarters hang multiple prints of René Magritte's painting *The Son of Man*. The company's execs see the image of a man's face obscured by a green apple as a metaphor for the millions who surf the Web anonymously. "Part of what Facebook is trying to do is help people take the apple away," says Chris Cox, the company's vice-president for product.

Facebook has good reasons to push people to be up front about who they are online. As the world's largest social networking site, it stands to reap a fortune if it can help customize advertising and product pitches to the characteristics of each user. But many people are reluctant to share personal information on the Web. They're particularly concerned about entrusting their identities to companies such as Facebook, which seeks to profit from the information it collects. "Fundamentally, Facebook is a business," says Kaliya Hamlin, co-founder of the Internet Identity Workshop advocacy group. "Their business is about monetizing the people in their network."

Facebook hopes to create a digital calling card that could identify people just about wherever they go on the Web

Almost any online activity leaves traces of your identity, from a Google search (what you're looking for) to an Amazon.com visit (what you're buying). Yet there's no widely accepted identity standard online—the equivalent of a driver's license or Social Security number. Facebook wants to change that by creating a digital calling card that could be used to identify people pretty much wherever they go on the Web. To help in the effort, in August Facebook hired one of the pioneers of online identification. David Recordon co-founded OpenID Foundation, a nonprofit group that maintains a set of open standards for Web identity. He plans to apply the foundation's principles of openness and transparency to Facebook. Already, the social network lets new users register with their name and password from Google's Gmail service, and Recordon says similar arrangements with other companies are in the works. "Standards are the plumbing layer of the Internet," says the 23-year-old. "For them to be successful they have to be freely shared."

Facebook argues that most services on the Web become more useful when they know something about users. One early example is Facebook Connect, a program that lets users log into their profile and interact with Facebook friends on more than 80,000 Web sites. When people sign in to YouTube with Facebook Connect, the video site highlights clips their friends enjoyed. For President Barack Obama's inauguration, CNN let online viewers use Facebook Connect to chat with others watching the ceremony. Almost 60 million of the social network's 350 million users have signed up for Facebook Connect in the year since it was introduced.

Facebook Connect is also integrated into Web-connected devices, including Apple's iPhone and Microsoft's Xbox gaming console. The technology lets friends play games and catch up with each other while they're away from the PC. Facebook expects that as a greater variety of devices connect



MARKHAM JOHNSON

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Facebook's Taylor, Recordon, Cox: Moving toward a more people-oriented Web

to the Net, users will see even more benefit. For example, you may soon be able to get in your car and tell the GPS to direct you to a person, rather than an address. "That kind of disruptive change can apply to a lot of different industries," says Bret Taylor, who works on Facebook Connect.

Such changes may also help companies profit from Facebook's data. On Dec. 2, Yahoo! announced a partnership with Facebook that will let users of the social network identify themselves on Yahoo sites and share articles, photos, and other content with friends. In part of the agreement that was not announced, Yahoo intends to tap Facebook user data to place display ads targeted to individuals on its own pages, according to a source familiar with the plan. In theory, this means advertisers will be able to pay Yahoo to get ads in front of a specific demographic group, such as women from California, if the users have shared their Facebook credentials with the site.

Those are the kinds of deals that make privacy advocates and individuals skittish. Facebook is already a big business, with estimated revenues of $500 million in 2009, and financial pressures are likely to grow as it considers an initial public offering. Facebook sparked an uproar this month when it made a series of changes to its privacy settings, including revoking the ability of users to hide their name, gender, profile picture, and hometown from anyone who views their profile. It also gave Facebook Connect partners access to the same information. The changes "reduced flexibility and control for users over their privacy in a myriad of ways," says Kevin Bankston, an attorney for the nonprofit Electronic Frontier Foundation.

Recordon's old friends at OpenID are raising warning flags, too. Chris Messina, a board member at the nonprofit, concedes his group's technology isn't as easy to use as Facebook's, but says Web sites should continue to support OpenID since Facebook may prioritize profits over privacy. "It's just too soon to let Facebook determine the future of identity on the Web," he says.

Facebook says it doesn't want to monopolize the development of identity technology. And Recordon claims that competition from companies such as Google will help push everyone to come up with ways to protect privacy while also helping people reap the benefits of sharing their identity. It's still so early, he says, "innovation is important." |BW|

Business Exchange

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To Catch a Twitterer

Can one go incognito in the Digital Age? *Wired*'s Evan Ratliff took a fake identity and went missing in August. A $5,000 reward lured a group of amateur gumshoes to find him using traces he left on Facebook, Twitter, and other sites. An entrepreneur in Seattle nabbed him in less than a month. Ratliff writes about it in the December *Wired.*

To view the story: http://bx.businessweek.com/data-protection-and-privacy/reference/

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Honda's Prius-Fighter Is Stuck in First

The Insight was aimed at bargain hunters. Turns out hybrid drivers expect a lot more car for their money

By David Welch

When Honda Motor launched the Insight in the U.S. in April, the aim was clear: Challenge Toyota Motor's green mantle by taking on its iconic Prius with a cheaper, super-efficient hybrid. "We're opening up Honda's hybrid technology to an entirely new group of buyers that previously may not have considered a hybrid because of either image or cost," said American Honda Executive Vice-President John Mendel at the time.

Turns out it's a very small group—an inconvenient truth that undermines the very rationale for Honda's hybrid strategy. A company spokesman concedes that the Insight will miss its sales target of 40,000 cars this year by a wide margin. And it's not clear that the Insight will ever seriously challenge the Prius because Honda has overlooked a lesson Toyota learned years ago: Hybrids aren't a budget purchase.

Consider that many Prius owners make well over $100,000 a year. That means this group can afford a much classier ride than a fuel-efficient hatchback. According to Toyota's research, hybrid shoppers are looking for lots of leg room and creature comforts. Toyota upped the ante with the third-generation Prius, which rolled out about the same time as the Insight. The latest model features bigger, more comfortable seats, extra horsepower under the hood, and some Lexus touches inside.

Next to a Prius, the Insight is a squeeze. That's because Honda based its design on the Fit subcompact. The Prius is built using a stretched version of the Corolla compact platform. The result: The Prius has a relatively spacious 94 cubic feet of passenger space, nine feet more than an Insight. Three adults can sit comfortably in the back seat of a Prius; not so in the Insight. "The Prius got bigger with every generation," says Eric Noble, president of the CarLab, an auto consultancy in Orange, Calif. "The car is no longer a compact. It's a legitimate family car."

It doesn't help that the Insight, despite being smaller and lighter than the Prius, gets only 41 miles per gallon in combined city and highway driving; the Prius gets 50 mpg.

Even the Insight's cheaper base price of $19,800 has proved no match for the Prius. When the Insight arrived earlier this year, Toyota had a bunch of last year's Priuses left; it quickly began offering rebates. Now, if it feels the need to goose sales, Toyota can remove the fancy Bluetooth phone system from its current Prius and put in a cheaper stereo. Doing so would allow Toyota to knock the Prius price down to $22,400—$700 more than a fully loaded Insight, says Edmunds.com.

Honda has another unanticipated issue. The Insight is eating into sales of its $24,000 hybrid Civic. When buyers arrive at showrooms they find that the Insight is cheaper. Plus the hybrid Civic looks almost exactly like the regular gas-powered version. The Insight, on the other hand, telegraphs instant green cred.

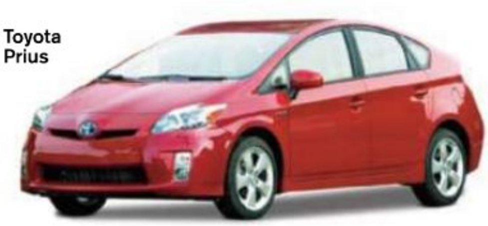
So far this year, the Prius is outselling the Insight by nearly 6 to 1. Other carmakers are watching closely. General Motors, for one, is reviewing its entire hybrid strategy. In late November, GM shelved plans for a 53-mpg Prius fighter for its bread-and-butter Chevrolet brand. GM product planners are starting to think they would be better off focusing on next-generation plug-in hybrids and electric cars such as the Chevrolet Volt, which is due next year. Even if those vehicles can't beat Toyota's Prius in the short term, they earn GM green-tech bragging rights. Given Honda's experience, GM may have the right idea. |BW|


Honda Insight

BATTLE OF THE HYBRIDS

	HONDA INSIGHT	TOYOTA PRIUS
Base price	$19,800	$23,400
November sales*	1,400	9,600
Fuel Economy	41 mpg	50 mpg

Data: Companies, Autodata, U.S. government *In the U.S.


Toyota Prius

Honda's experience convinced GM that it's better to focus on next-generation electric cars than fight the Prius head-on

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The Latest Credit-Card Tricks

With new federal rules looming, card issuers are concocting creative ways to collect fees



Sweeping 2009 reforms take aim at the industry's most abusive practices, including abrupt interest rate changes and late-payment fees. But credit-card companies keep coming up with new ways to charge customers. *–Alexis Leondis, with Jeff Plungis*

RATE FLOORS

Under the new rules, companies will find it difficult to jack up fixed-interest rates at will. That's why issuers are moving consumers into variable-rate cards, which are tied to an interest-rate index. But borrowers may not benefit when the index drops since companies are limiting how low card rates can go. In October consumer advocate attorney Lauren Bowne saw the 5.9% promotional rate on her Wells Fargo card switched to a variable one with a minimum rate of 19.1%. As of July, 5 of the 12 largest banks that issue cards, including Wells, had floors under rates, says Pew Charitable Trusts, a nonprofit. Wells says floors under variable rates have been standard practice for at least three years.

PICK A RATE

Almost 120 million accounts may be affected by a change that will allow issuers—when setting the variable rate on a card—to pick the highest rate in the past three months from the interest-rate index it tracks. Previously, companies used the rate on the last day of the billing cycle. The result is that borrowers pay an average interest rate that is 0.3 percentage points higher than before. The card industry could generate $720 million a year from this shift, estimates the Center for Responsible Lending, a consumer advocacy group.

LOWER FEE THRESHOLDS

Policymakers took a swipe at late charges by requiring a 21-day grace period for consumers to pay their bills. When cardholders don't make their payments by that deadline, they're likely to get smacked by bigger fees than in the past. Generally the charge goes up with the size of the balance. Five years ago issuers levied the largest fee on balances of $1,000 or higher. Now, it kicks in at around $250. Some 87% of cardholders pay the highest amount, according to the Center for Responsible Lending.

UNLIMITED FEES

Borrowers that move balances from one credit card to another with a low introductory rate may pay more for the privilege. Bank of America recently upped its fee to as much as 4% of the balance, from 3%; at JPMorgan Chase, the charge can be as high as 5%. And while companies used to cap the total amount that customers would pay for a balance transfer—at, say, $50—fewer companies are doing so anymore. Roughly 68% of balance-transfer deals in the second quarter of 2009 had no limits on fees, compared with 44% the previous year, says Mintel Comperemedia, a firm that tracks marketing trends.

INACTIVITY FEES

While consumers try to cut back on spending, they're increasingly penalized for not pulling out their plastic. More issuers are hitting cardholders with fees for not using their cards or closing accounts that have balances. The annual charge can run as high as $36, according to the Center for Responsible Lending. In June, Fifth Third Bancorp in Cincinnati added a $19 inactivity fee on most of its cards. "We want to encourage active use and management of the accounts," says Fifth Third spokeswoman Stephanie Honan.

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Japan: Boosting Growth with Day Care

An ambitious plan aims to spur the birthrate and get more women back into the workforce



Yoko Furukawa may not be able to keep her job when her son turns three

TOMOHIRO OHSUMI/BLOOMBERG

By Tomoko Yamazaki and Komaki Ito



TOKYO

Nana Nakagawa would love to have another baby, but given the problems she has finding day care for her two-year-old daughter, she's not sure she could manage. Although her apartment complex in the port city of Yokohama has a nursery, more than 50 children applied for fewer than 10 spots. So Nakagawa's morning commute involves a train ride and a walk to a different day care center, then another hour on the train to her job at Daiwa Securities in Tokyo's Marunouchi business district. "I realize that the clock is ticking," says the 33-year-old, "but unless I get more backup from the government, it's difficult to imagine having a second child."

As Prime Minister Yukio Hatoyama sets about getting Japan's economy back on its feet, he understands he needs to help women like Nakagawa. On Dec. 8, Hatoyama's government said it would spend $225 million to expand day-care facilities. The effort is part of an $81 billion economic stimulus package, a sweeping measure that includes everything from subsidized loans for small businesses to incentives for eco-friendly cars and appliances. The government "aims to create a society in which everyone can play a role," Hatoyama said in a speech to Parliament on Oct. 26. "This will mean promoting gender equality in all aspects of life, including employment and child-rearing."

With the lowest birthrate of any industrialized country—1.34 children per woman—Japan has a dramatically shrinking population, so there are fewer workers to support growing numbers of pensioners. Providing easy access to child care would make women more willing to have babies, says Social Affairs Minister Mizuho Fukushima, who has been instrumental in the push to improve day care. "Women working for companies have long hours, and that's a struggle," Fukushima says. She knows how hard it is: When her daughter was young, she had to move to a new neighborhood to get after-school care that would allow Fukushima to continue her work as a lawyer.

Just as important, better day care could bring more women back into the workforce, boosting economic growth. Last year, just 67.5% of Japanese women worked, vs. more than 80% in Scandinavian countries and 72.3% in the U.S. Increasing that rate would give a big boost to consumer spending, according to Dai-ichi Life Research Institute, and it could send the Nikkei 225 Stock Average up by more than 3%—creating $70 billion in wealth. "Given how acute the demographic pressures are, Japan can't

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afford not to make better use of its women," says Kathy Matsui, the chief strategist at Goldman Sachs Japan and a mother of two.

So far, details of Tokyo's plans for improving day care are vague. Early next year the government aims to ease rules restricting the maximum number of children at Japan's nearly 23,000 day care centers, and Hatoyama plans to offer families a monthly allowance of $145 per child under 15. Some skeptics, though, say many Japanese women are far more interested in careers and travel than in having children, so the government's efforts may have little effect. "I just don't believe it's a matter of child support," says Nicholas Smith, strategist at MF Global FXA Securities. "It's a matter of changing the mindset."

Hatoyama can look to France as a model. Since expanding child support programs in 2004, Paris has provided as much as $660 a month to subsidize day care, hands out $1,300 for each newborn, and offers families some $260 monthly for each child under three. French women now give birth to an average of 1.96 children each, the most in Europe and up from 1.78 a decade ago.

The emphasis on getting women back to work represents a significant change in Japan. Under the previous Liberal Democratic Party government, which Hatoyama's Democrats unseated in August elections, the issue received little attention. Just three years ago, then-Health & Welfare Minister Hakuo Yanagisawa said Japanese women—whom he called "baby-making machines"—simply needed to get busy (though he later apologized for the remark). "Until now, efforts to improve child-care facilities were shoved aside because they didn't win votes," says Yutaka Sanada, a manager at a trade group representing after-school care centers.

"I just don't believe it's a matter of child support," says one skeptic. "It's a matter of changing the mindset"

Many experts believe Hatoyama must move quickly. Japan has already returned to deflation, the downward spiral of prices that plagued the country for a decade until 2006. And economic growth was an anemic 1.3% in the third quarter, while the yen's rise to a 14-year high against the dollar is threatening corporate profits.

Any change will be welcomed by Yoko Furukawa. The 28-year-old public-relations executive loves her job at shipping line Nippon Yusen, but she's worried about keeping it. When her son turns three next November, he'll no longer be eligible for the company nursery, and Furukawa fears she won't find an alternative: "It would almost be a miracle for my child to get into any of the government-run centers." |BW|

—With Takashi Hirokawa, Shingo Kawamoto, Helene Fouquet, and François de Beaupuy

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Safyer (center): More insurance "adds up to a much worse shortage"

JENNIFER S. ALTMAN

ECONOMICS & POLICY

Physician, Clone Thyself

Health-care reform could mean a big doctor shortage as 30 million new patients fill the waiting rooms

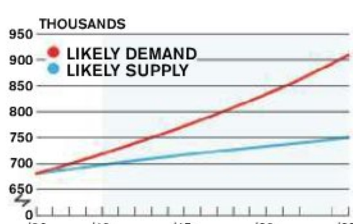
By Pat Wechsler

Presuming Congress passes some version of a health-care bill and it is signed into law, some 30 million currently uninsured people will suddenly find themselves with access to doctors. But there may not be enough doctors to see them.

In 1997, lawmakers placed a cap on the number of medical residencies—hospital training required for all doctors—in order to contain costs under Medicare, which pays for most of these training slots. Today the U.S. is in the grip of a nationwide doctor shortage, brought on by an aging population demanding access to specialists.

SHORTFALL

Demand for physicians will continue to outstrip supply



Note: Does not take stock of the anticipated impact of health care reform
Data: Association of American Medical Colleges

Medical schools have stepped up to the plate, announcing plans to add 3,000 new positions for first-time students by 2018. But because the residency cap is still in place, these efforts may not be sufficient.

The health-care overhaul is certain to compound the problem by flooding doctors' offices with newly empowered medical consumers. "Do the math," says Steven M. Safyer, president and CEO of Montefiore Medical Center in New York. "You give millions more people insurance, and it adds up to a much worse shortage."

The doctor crunch is already dire. Last year there were nearly 17,000 fewer primary-care doctors than needed in inner-city and rural areas, according to the U.S. Health & Human Services Dept. By 2025 there will be a shortage of as many as 159,300 doctors, predicts the Association of American Medical Colleges.

Medical schools are trying to help, adding 1,500 seats since 2005. Tufts University boosted its first-year enrollment by 12% in 2009. Dartmouth College increased seats by 7.7%, and the University of Tennessee was up 10%. Still, "It takes years to produce doctors," says Steven H. Lipstein, president and CEO of 13-hospital BJC HealthCare in St. Louis, which trains residents from Washington University.

Federal officials hope to ease the shortage by raising the number of residencies available to students, says Robert Feinstein, senior associate dean for education at the University of Colorado Denver School of Medicine. The cap that stands in their way affects 90,000 of 110,000 residencies at U.S. hospitals, according to the medical college association.

Medicare pays about $100,000 a year per residency, at a total cost to the program of about $9 billion, according to a report filed in June by the Medicare Payment Advisory Commission. The funding was set up in 1965 when the U.S. was about to extend government health coverage to 19 million elderly Americans. As the Medicare rolls grew, to 45 million as of the end of 2008, a ceiling was placed on the number of residencies to control spending.

Congress is now trying to reverse course. On Dec. 5, Senate Majority Leader Harry Reid (D-Nev.), along with Charles Schumer (D-N.Y.), Bill Nelson (D-Fla.), and other sponsors, submitted an amendment to the health-care reform bill that would add 15,000 residencies at a cost to Medicare of about $1.5 billion, according to Atul Grover, a lobbyist with the medical college association. But because Congress is still looking to keep costs down, that figure may drop, if the change is approved at all, during the debate. |BW|

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IBM's Gammons is wowed by the speed at which China makes big moves

MARK LEONG/REDUX

INNOVATION & TECHNOLOGY

A Power Play For China's Electrical Grid

With Beijing budgeting $600 billion to upgrade its network, global giants are racing to plug in

By Bruce Einhorn



BEIJING

To cure a Texan of his belief that everything is bigger in Texas, send him to China. Four months ago, Brad Gammons moved from Amarillo to Beijing to help IBM land some of the $600 billion the Chinese government plans to spend over the next decade on its electrical network, especially on smart-grid technology to boost efficiency. Now the 50-year-old IBM vice-president marvels that "the scale and pace of how things move here is not something you experience anywhere else in the world."

Gammons is part of an influx of energy specialists aiming to remake China's electric system. Companies from around the world are eyeing contracts with State Grid and China Southern Power Grid, the government enterprises in charge of power distribution. China's spending eclipses the $8 billion Washington and U.S. companies have earmarked for similar projects—smart meters, software, and consulting to digitize the grid and conserve energy. "The opportunities in China are breathtaking," says Peter Larsson, a vice-president at Echelon, a California company that makes software measuring electricity delivery.

SKYROCKETING DEMAND

As the mainland's economy surges, so do its power needs. China is the No. 2 consumer of electricity after the U.S., using 3.4 trillion kilowatt-hours in 2008—double its usage six years earlier. But China consumes about four times as much electricity as the U.S. per dollar of gross domestic product and eight times what Japan does, the International Energy Agency estimates.

IBM expects at least $400 million in smart-grid revenues in China over the next four years, but competition for those dollars will be stiff. General Electric, Hewlett-Packard, Cisco, Westinghouse, ABB, and Siemens are all vying for a piece of the market. ABB, for instance, is pushing systems to manage power plants and transmission lines. And HP, which has long supplied computers to the research arm of State Grid, hopes to parlay those contacts into deals for managing smart meters, which let consumers see how much power they use at different times of day and adjust their consumption accordingly. With its centralized system and just two companies operating the grid, "China has an opportunity to move faster than many other countries," says Douglas Hanson, HP's director of global energy and resource industries.

Big consulting companies are trying to get in on the action, too. Accenture is working on 10 smart-grid projects on the mainland, including one to help power plants better recognize rapid changes in consumer demand in real time. Smart-grid consulting will be "a very big wave for us," says Michael Ding, a managing partner for Accenture in China.

A handful of Chinese outfits have ambitions in smart grids, but it's one area where Westerners have relatively few worries about losing out to domestic rivals. While Beijing wants to give preference to Chinese-made tech gear, in smart grids there's not enough local expertise to meet the country's massive needs. "China is still at an early stage," says Sam Zhou of Boston Consulting Group, which hopes to win contracts advising the Chinese on smart-grid projects. "Chinese companies are starting to study, but they are still behind the foreign companies." |BW|

—With Mark Scott in London

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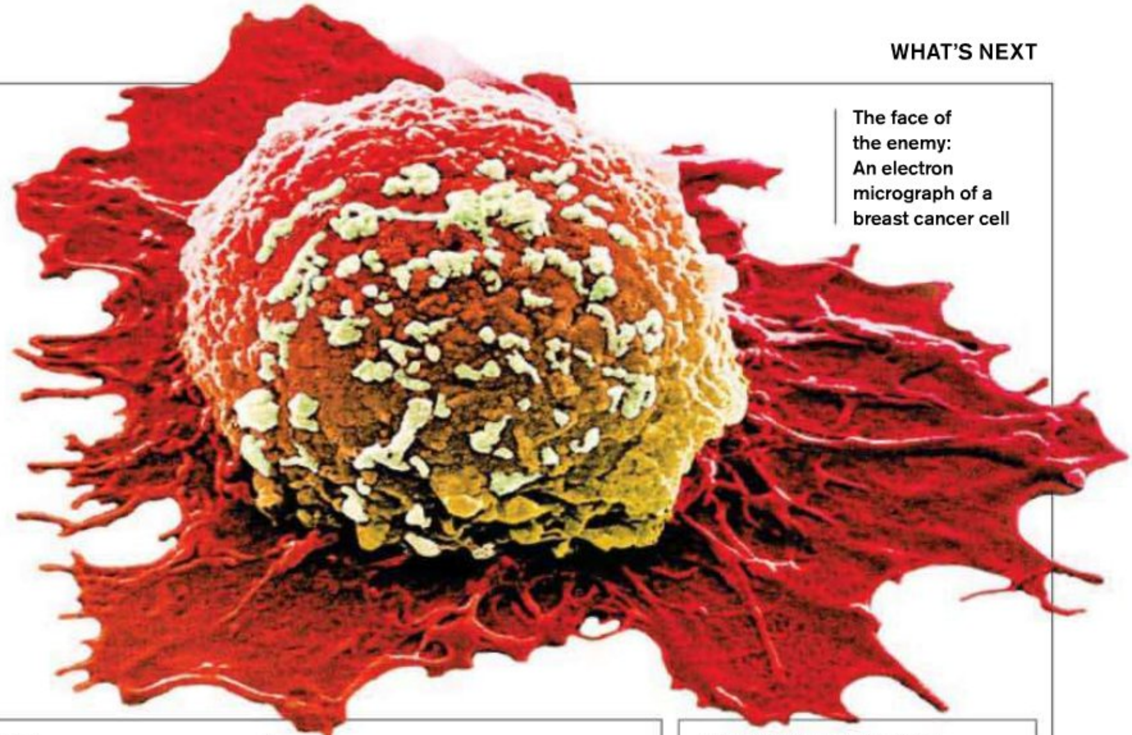
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The face of the enemy: An electron micrograph of a breast cancer cell

THE WAR ON BREAST CANCER

At the annual San Antonio Breast Cancer Symposium, Dec. 9-13, researchers and physicians traded the latest information on drug discovery, ongoing clinical trials, the genetics of cancer, preventive therapies, and more. Bloomberg's Rob Waters filed these dispatches from the meeting.

COMBINATION THERAPIES

Herceptin Helps Deliver a Warhead

Roche and ImmunoGen reported on a "guided missile" combination drug called T-DM1 that shrank tumors by 30% or more in one-third of critically ill, advanced breast cancer patients in a trial. The therapy combines Roche's Herceptin with a second, potent cancer-killing drug from ImmunoGen, with Herceptin acting as the guidance system, using its ability to home in on cancer cells to deliver the treatment directly to its target.



Junius: ImmunoGen delivers the death stroke to tumors

Jason Kantor, an analyst for RBC Capital Markets in San Francisco, says the combination therapy has the potential to replace the use of Herceptin alone for patients whose breast cancer has spread. The news capped a strong year for ImmunoGen, which has seen its shares more than double this year under CEO Dan Junius.

There was additional good news for Herceptin, which had sales of $4.7 billion last year. A separate study at the meeting added to existing evidence that the drug can help breast cancer patients with the gene variant known as HER2 survive for five years after they are diagnosed. Women taking chemo drugs called anthracyclines in combination with Herceptin fared better than women taking the chemo without Roche's drugs.

OSTEO PROTECTION

Stronger Bones Build Resistance

Two separate studies discussed at the symposium showed that bone-building drugs such as Merck's Fosamax, Novartis's Zometa, and Roche's Boniva may cut older women's risk of breast cancer. One paper, drawing on data from the ongoing Women's Health Initiative, a large study backed by the federal government, showed that postmenopausal women taking either Fosamax or another drug in the same class had a 32% lower rate of developing breast cancer. A smaller Israeli trial found a 29% reduction.

Some researchers concluded from these and earlier studies that patients get protective benefits from any of the drugs in this class, known as bisphosphonates. And women may not need to be on the drugs any longer than one full year to reap lasting results, one researcher said, because the chemicals remain in the bones for a year or more.

EXISTING TREATMENTS

New Hope from Old Drugs

Onyx Pharmaceuticals and Bayer said their Nexavar pill, sold in more than 70 countries to treat cancers of the liver and kidney, extended the lives of women with advanced breast cancer by delaying growth of malignancies that had spread or recurred. Tumors in two-thirds of women treated with Nexavar and the chemotherapy paclitaxel shrank by at least 25% and were stable for an average of 8.1 months. About half of those on paclitaxel alone had shrinkage, and they were stable for 5.6 months, the study found. If Nexavar (right) is approved for late-stage breast cancer, the market could be substantial: an estimated 57,000 U.S. women are afflicted, according to Robert W. Baird & Co. analyst Christopher Raymond.



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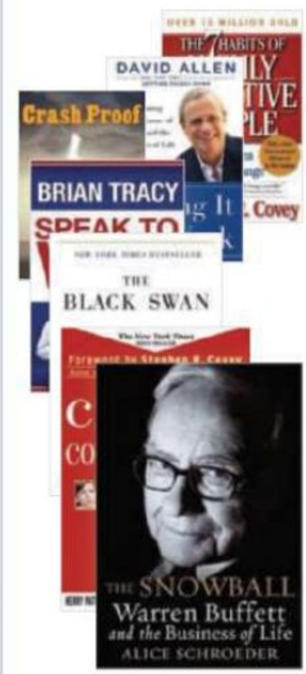
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Helping Urban Startups Get Started

Activists are rolling out new funds tailor-made for inner-city entrepreneurs

By Kimberly Weisul

SMALL BIZ

It's a common lament among small companies: The amount and type of financing entrepreneurs are able to raise seldom match what they actually need. That's especially true for startups that may not be quite ready to put a multimillion-dollar venture capital investment to work. "Our companies are looking for $500,000 to $1.5 million," says José Corona, executive director of Inner City Advisors, an Oakland (Calif.) nonprofit that helps prepare small companies to win equity investments. "But funds are making minimum investments of $2 million to $3 million." Other small companies would prefer debt, but in the current credit environment, they're considering selling equity.

Now Corona and two other advocates for inner-city and minority-owned companies are tackling that problem. In a terrible fund-raising climate, they want to launch investment vehicles that will provide small amounts of early-stage equity, later-stage financing, and, in some cases, debt. "These funds will help companies get the financing that is right for them and not get pigeonholed by the first people who are interested," says Deborah Shufrin, a senior vice-president at the nonprofit Initiative for a Competitive Inner City

A. RICHARD ALLEN








The secret of running a successful small business?

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Start mentors about 80 companies, most of them technology-related, but CEO Ray Leach says that only 8 to 10 of them will typically find financing in a year. That leaves plenty of promising candidates for Todd's fund, like Cleveland's M.O.M. Tools, developer of a manfacturing tool that lasts six times as long as its competitors'. "They're in the process of raising capital," Leach says, "and they've struggled."

in Boston, which works to promote inner-city economic growth.

Corona aims to raise $25 million. Eugene Todd, a former investment banker, has a target of $40 million. Both will make initial investments of $500,000 to $1.5 million, and both will rely on nonprofits to help them find high-growth entrepreneurs. Corona's fund will work with Inner City Advisors, while Todd is partnering with Cleveland's JumpStart. Jump-

Tim Ferguson, founder of Next Street Financial, a Roxbury (Mass.) financial advisory firm, is taking a different approach with his $100 million fund, which will provide slightly larger companies with $2 million to $5 million in debt-based financing. "In this particular space, there's less interest in equity because people don't want to give up control," Ferguson says. Next Street will manage Ferguson's fund and advise its portfolio companies.

Todd is looking to large banks to invest in his fund. Because getting that money can involve up to a year of due diligence, he's also approaching local and regional banks and corporations "who know us, think this is a good thing, and have seen us in the community." Todd has raised $7 million and will begin investing once he reaches $10 million—by March, he hopes. Corona is first approaching high-net-worth individuals and may later pitch to pension funds, banks, and foundations.

Working against them all is the perception that funds backing a social good—in this case, boosting inner-city and minority-owned companies with the potential to create jobs—aren't profit-focused. Explains Corona: "Once you say you're a social fund, everyone jumps into thinking you're wasting their money." Instead, "We're telling [investors] we're looking at inner-city companies as an emerging asset class. It won't be market-rate, but we'll give a good return on investment and a great social return." |BW|



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BOOKS | PAUL M. BARRETT

Grandstanders in the Corner Office

An entertaining attack on the American-style practice of glorifying—sometimes deifying—the corporate CEO



DOUG FRASER

It will come as no surprise that a pair of French academics view the notion of heroic CEOs with Continental disdain. "As Europeans, we claim the right to present the history of entrepreneurs from a perspective different from that of the simple success story," write Michel Villette, a sociologist at AgroParisTech, and Catherine Vuillermot, a business historian at L'Université de Franche Comté, in the opening pages of *From Predators to Icons: Exposing the Myth of the Business Hero*. Europeans, it seems, see through the flimflam of crass commerce.

Captains of industry get ahead not by means of productive risk-taking and innovation, Villette and Vuillermot argue, but by "predation": ruthless exploitation of market imperfections and rivals. The distinction between "good bosses" and "crooked bosses" is a fiction perpetrated by corporate propagandists. "The businessman spends his time getting around the laws and ordinary conceptions of morality."

Nuanced they ain't. Still, these pretentious, Marx-quoting scholars offer an entertaining reminder of just how passionately some of our friends abroad resent material success. And, as John R. Kimberly, a professor at Wharton, notes in a forward, *From Predators to Icons* arrives on American shores at "a time when leadership in the world of business in general and finance in particular has been found seriously

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wanting." Wacky as they often sound, the French professors proffer a few thoughts worth pondering.

POLITICAL CHOICES

The research behind this book consists primarily of a close reading of the biographies and autobiographies of business titans: Jack Welch, Sam Walton, John Scully, Richard Branson, and the like. Many of these accounts are, to put it politely, not very rigorous.

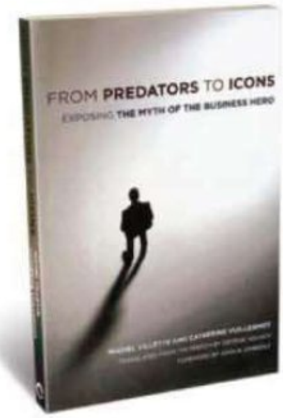
Then again, if you buy a book called *Jack: Straight from the Gut*, by former GE chief Jack Welch (with former *BusinessWeek* Executive Editor John A. Byrne), what do you expect? Villette and Vuillermot profess dismay that the late Sam Walton's *Made in America: My Story* (written with John Huey, now editor in chief of Time Inc.) dwells more on folksy Arkansas rags-to-riches themes rather than the systematic elimination of Wal-Mart's rivals and merciless squeezing of its suppliers.

Reading between the lines, one can discern that the French scholars' main complaint is that business creates losers as well as winners—and that the latter don't always play nice in vanquishing the former. Welch imposed discipline by routinely firing underperformers and dumping mediocre divisions. Sam Walton cut prices for consumers but also knocked off countless mom-and-pop stores on Main Street.

Modern commerce is rough, no doubt. If Western Europeans choose to sand the edges with greater regulation and more generous social benefits—as many do—well, that's their political choice to make. Americans, for better and sometimes for worse, make different collective choices.

The authors of *From Predators to Icons* are as guilty of cartoon stereotyping as the corporate titans and hagiographers they criticize. They are blind to the Olympian energy, occasional philanthropy, and, yes, sheer genius demonstrated by some (not all) corporate giants. Bill Gates comes to mind in the more positive category, whatever you think of the PC vs. Mac contest. CEOs deserve clear-eyed scrutiny: criticism for their foibles and praise for their accomplishments.

What I nevertheless like about this screed is that by dwelling on the dubious genre of corporate tributes, it reminds readers how susceptible business leaders are to monumental self-delusion. That capacity for vain irrationality helps explain Wall Street's subprime-financing fiasco of 2008 (sure, we should underwrite billions in mortgages that borrowers can't possibly pay back!), just as it can be found entwined with the roots of the Enron/WorldCom-era corporate scandals, the late-1990s dot-com mania, the savings-and-loan crisis, and so on, back through the history of capitalist debacles.



From Predators to Icons: Exposing the Myth of the Business Hero **by Michel Villette and Catherine Vuillermot**
Cornell University Press; $24.95

Rather than take business legends at their word, Professors Villette and Vuillermot propose interpreting the laudatory biographies according to Sigmund Freud's principles for analyzing neurotic dreams. Distortion and displacement come into play.

Airline tycoon Richard Branson, the authors contend, emphasizes his dedication to the public interest and distaste for high unemployment as a way of displacing his tendency to pay many employees modestly and to shelter corporate earnings in offshore tax havens. Claude Bébéar, the French insurance mogul, distracts himself from a hard-nosed decision to bring in the police to deal with strikers by focusing instead on his visit to the charming home of the Minister of Justice. Before he can request platoons of strikebreakers, the powerful executive must obey the demand of the minister's wife that all guests put on cloth slippers when entering her salon. Such delightful details obscure Bébéar's true nature as "a heartless boss" and an "advocate of repression," according to the authors.

Don't expect Wharton or Harvard to start offering a joint graduate degree in business administration and psychotherapy. No university is likely to take this line of reasoning that seriously—and even if a business school were to try to get on this wavelength, the authors of *From Predators to Icons* provide little in the way of constructive prescriptions for a curriculum. But their intemperate cry from the ivory tower is an amusing counterbalance to the usual paeans to occupants of the C-suite. |BW|

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Build Them Up

A 2004 research paper titled "Believing One's Own Press: The Causes and Consequences of CEO Celebrity," published in the *Strategic Management Journal*, examines journalists' tendency to give CEOs too much credit for the actions and performance of their companies. This type of coverage, the authors argue, can breed overconfidence among CEOs, clouding their judgment.

To read the paper, go to **http://bx.businessweek.com/leadership/reference/**

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TECH & YOU | RICH JAROSLOVSKY



From the Web to Your TV, Seamlessly

Roku, no longer just "the Netflix box," adds content and new models

When Roku's original set-top box launched last year, it did one thing, simply and well: Allow Netflix customers to view Internet-delivered movies instantly on their televisions. With new models and content sources, Roku is doing a growing number of things—still simply and well. The new hardware and content give Roku a spot in the race to control how Net-delivered entertainment finds its way onto your big TV. With the field growing more crowded by the day, though, no one is close to claiming victory.

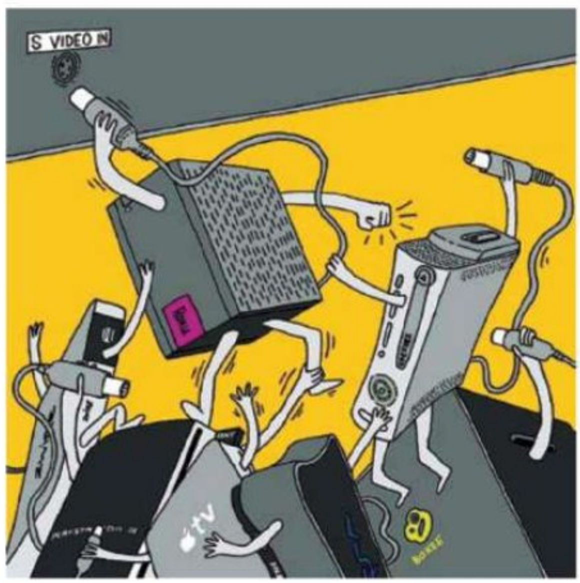


ILLUSTRATION BY PETER ARKLE

Roku's black box is about the size of a stack of four CD cases, and it's all but invisible on a shelf with other gear. There are now three models: A \$79 entry-level box provides only a standard-definition signal; the \$99 model provides higher-definition connections, including HDMI; and the \$129 HD-XR works with the latest Wi-Fi standard, called 802.11n.

Setup is dead easy. Plug the Roku box into a TV and a wall socket and it automatically locates and displays all available wireless networks. Just select yours using the simple remote control and enter a password, if you have one. Out of the box, Roku provides three sources of programming: Netflix, which gives customers of its DVDs-by-mail service unlimited access to a library of some 17,000 movies and TV shows that can be watched instantly; Amazon.com's Video on Demand service, which claims more than 50,000 titles you can either rent or purchase and store on Amazon's servers; and the MLB.TV Premium service, which, for a fee, streams live out-of-market baseball games.

Net-delivered video plays without interruption or stutters, and with picture quality that matches DVD or cable

Accessing those services can be a bit of a pain. You'll need to set up accounts on your computer or, if you already have an account, log into it and enter an activation code from the TV screen. I'm ashamed to admit I ran up and down the stairs between den and computer a few times before realizing I could enter the codes on the browser of my smartphone.

Once I was set up, the fact that I was watching content streaming over the Net was entirely irrelevant. Video played without stutters or interruptions. I could stop, rewind, or fast-forward, navigating via handy thumbnail images on the screen. Picture quality varied depending on which connection cables I used, but was never any worse than on a DVD or on cable.

Roku's new channel store adds access to photos stored on Flickr and Facebook, videos from blip.tv, Revision3, and Mediafly, and music from Pandora's Internet radio service. You can also use MobileTribe, a paid service that aggregates content from your social networks.

Still, Roku provides no DVD-type extra content, nor solutions for accessing hulu.com's TV programming or YouTube. And I wonder how important some of its more cutting-edge channels will prove to be in a device that, after all, is designed to be easy enough for your Aunt Agatha to use.

Roku faces an imposing list of contenders. Among them, Microsoft and Sony deliver Net content via their game consoles, the Xbox 360 and PlayStation 3, while Apple keeps nibbling at the edges of the market with its Apple TV. Boxee, whose software lets computer users locate, play, and share videos, just announced it's working with manufacturer D-Link on a device that brings this capability to your TV.

These days it matters less and less whether content is piped over the Net, cable, satellite, the airwaves, or stored on a hard drive. What does matter is that it gets delivered with a maximum of choice and a minimum of fuss. Roku already has a pretty good handle on the minimum-of-fuss part. |BW|

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AFRICA

FIGHTING WORDS FROM—AND TO—DOMINION FARMS

I read with great disappointment "Land Rush in Africa" (In Depth, Dec. 7). My company, Dominion Farms, was inappropriately vilified over its farming activity in Kenya. Dominion, established in 2003, is a large-scale farm committed to producing sustainable high-quality rice and fish while enhancing the lives of our employees and the community in which their families live.

Dominion Farms is more than a business. It is my life's mission, and it has invested more than $34 million in one of the poorest areas of Africa. I have firmly stood against corruption and individual self-interest, often being met with opposition. We have had accusations made against us by those whom we have come to assist, but this does not deter us from our mission to help them. The farm has suffered floods and hail and survived a civil war. The beauty of this story is that Dominion is still standing in the midst of poverty, disease, and superstition. We provide food security, jobs, and hope to an otherwise neglected people. Currently, I am in Kenya on my 68th trip and honored to lead the 700 employees we have here today. The love of the local people is overwhelming, and their dedication to our continued success is admirable.

My goal is not personal profit. But the farm must be profitable to expand and continue providing jobs and opportunities. We have a training facility that educates the youth, equipping them with knowledge, vocations, modern farming techniques, and life skills. This enables more productive lives for future generations.

Dominion Farms' emphasis is on what can be done, not what cannot be done, in Africa. The Dominion story is not about the struggle, but about perseverance and commitment to lift the lives of the poorest of the poor. To learn more we invite you to visit Dominion Farms in Kenya, or view our Web site at dominion-farms.com.

Calvin Burgess
CEO, Dominion Farms
GUTHRIE, OKLA.



Burgess and Charles Onyango Apiyo are at odds over the Kenyan's cattle

Africa needs investment partners, not handouts from the developed world, and that is exactly what Dominion is doing. In fact, food security should be the right way to go to enable the continent to feed itself.

Screen name: Okoth Otura

Thanks for giving the rest of the world this information. Dominion does not offer any job opportunity to the people around the farm but is exploiting human rights and destroying the environment. Dominion acquired the land through corruption.

Screen name: Charles Chalo

This article illustrates just how tough the agriculture situation is in Africa. In theory, it's good for companies like Dominion to come in and offer their resources and expertise. But despite what Burgess says, it doesn't seem to be working very well. The time of the top-down approach may be over.

Screen name: Eleanor

Let us focus on evaluating the fundamental question raised in this article: Is the rush to invest in land and farming in Africa the new colonization? Are these investors setting up social enterprises whose monetary dividends are shared 100% among the local communities? What is the social dividend accrued to date by these communities?

Screen name: Sarah Lutta

Being African, I am disheartened. Corporations will always maximize profits. It is up to the people to hold local and national governments accountable. Even in the developed world, companies engage in profits first, but when they get "caught," they pay a hefty price. Africans need to realize outsiders will never solve their problems. They have to make a conscious decision to improve their countries, much like China and Singapore.

Screen name: AlfajiriKenya

CORRECTIONS & CLARIFICATIONS

In "Omaha on the Hudson" (Cover Story, Dec. 21), the title of Jeff Ennis of Wilshire Associates was incorrect. He is chief investment officer.

"John Paulson Returns to Earth" (What's Next, Dec. 14) said the hedge fund manager doubled his stake in Kraft Foods, which is making a hostile play for Cadbury. He doubled his position in Cadbury.

NANCY NEWBERRY AND TIM FRECCIA

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Why 2010 Looks So Dicey

Households will remain twice-shy, and deflation may linger. Invest defensively

The defining characteristic of this asset and credit collapse has been the implosion of the largest balance sheet in the world: the U.S. household sector. Even with the equities rally and the tenuous recovery in housing in 2009, the reality remains that household net worth has contracted nearly 20% over the past year and a half. That's an epic $12 trillion of lost net worth, a degree of trauma never seen before. As households assess the damage, the impact of this shocking loss of wealth on spending patterns is likely to be enormous. Frugality is more than just the new fashion; attitudes towards discretionary spending, home ownership, and credit have undergone a secular shift toward prudence and conservatism.

Complicating matters is the approaching 53rd birthday of the median baby boomer. Many members of this critical mass of 78 million (who have driven the economy and capital markets over the past five decades) are now in their 60s. They're realizing they may never fully recoup their lost net worth, and yet they'll probably live another 20 or 30 years. So what is happening—at once both fascinating and disturbing—is that people over 55 are the only part of the population seeing any job growth now. Retirees who left the workforce are rejoining it to make up for their lost wealth.

They're certainly not banking on the current bear market rally, which is being driven by investors purchasing stock to cover their short positions and hedge funds, the only two major sources of equity buying power this year. What has impressed me is that the general public has been allocating more of its savings to fixed-income strategies. For every dollar the household sector has invested in capital appreciation funds since the March lows, more than $10 has flowed into income funds—bonds, hybrids, dividends, and the like.

When I look at household balance sheets, what I see on the asset side is a 25% weighting toward equities and a 30% weighting toward real estate. There is a lot in cash and deposits, life insurance reserves, and consumer durables, and the weighting in fixed-income securities is still less than 7%. This is the part of the asset mix that will expand the most over the next decade.

People have understandable concerns about inflation right now, but the history of post-bubble credit collapses shows that even with massive stimulus, deflation pressures can dominate for years. This was certainly the case in the U.S. in the 1930s and in Japan from the 1990s until today. All the talk right now is about efforts by central banks to create inflation. The facts on the ground, however, show that the inflation rate for both U.S. consumers and producers has turned negative for the first time in six decades. To protect a portfolio in this deflationary landscape, a pervasive focus on capital preservation and income orientation—whether in bonds, hybrids, or an emphasis on consistent dividend growth and yield—would seem to be in order.



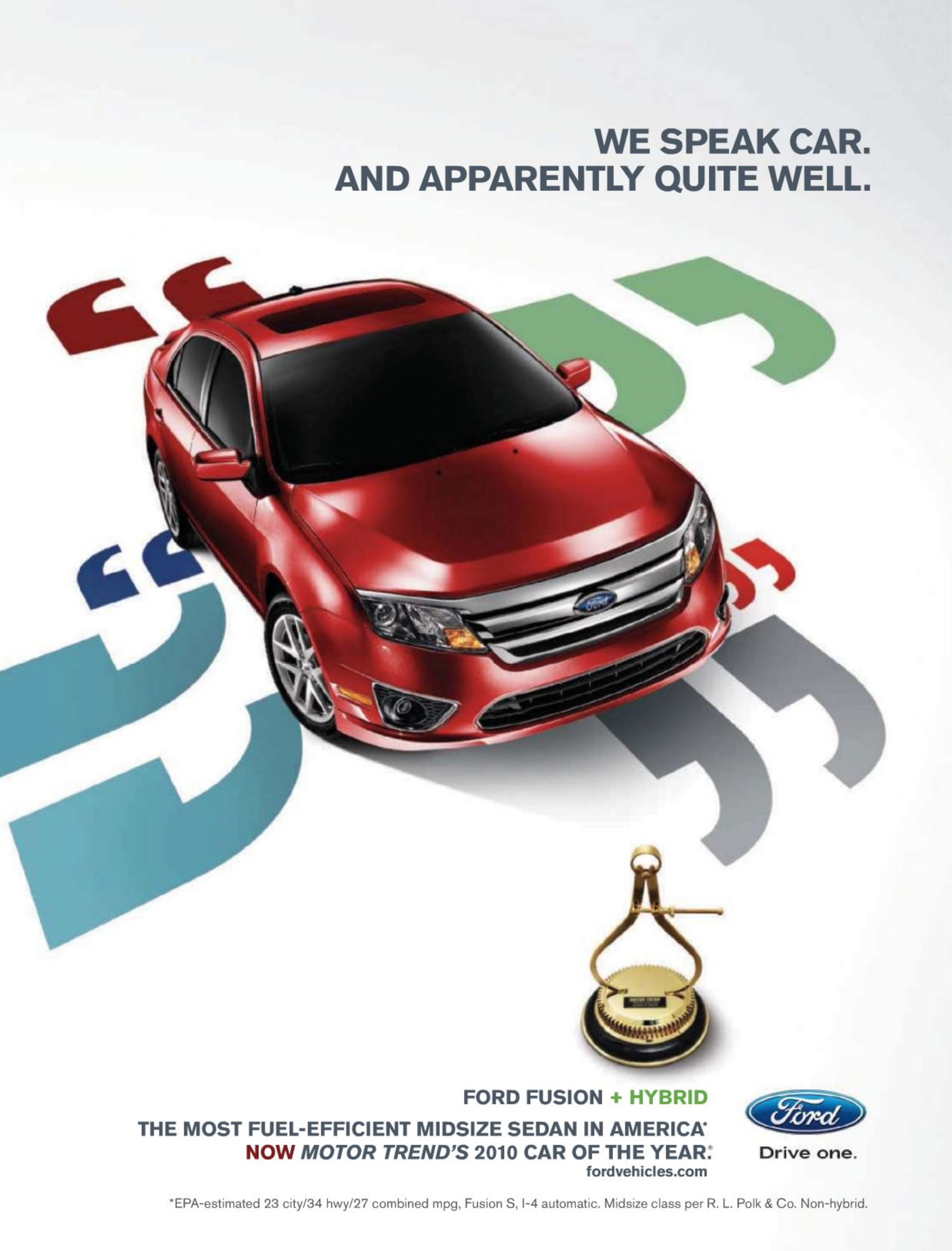
It's becoming clear that the government's attitude to the beleaguered greenback can only be described as benign neglect. With midterm elections in 2010, the Obama Administration will do everything it can to tack every last possible basis point onto gross domestic product growth and to prevent the unemployment rate, the most emotionally charged statistic of all, from reaching new highs. The decisions to give 57 million Social Security recipients an additional $250, and not only to extend the tax credit for first-time home buyers but to expand the subsidy to higher-income, trade-up buyers, smacks of a populism that will stop at nothing to generate growth, even with the deficit-to-GDP ratio already at a record of more than 10%.

While I believe a sustainable return to inflation is a long way off, there is little doubt we will see continuous efforts at reflation, which means the U.S. money supply will continue to expand rapidly, a positive for commodities, which are after all priced in U.S. dollars. And it appears that strong Asian growth—in China and India in particular—has been a key reason why the Canadian stock market, with its resource exposure, has continued to do well compared with U.S. markets, especially in light of the strengthening Canadian dollar. I expect commodities to continue to outperform. Typical of a post-bubble credit collapse, I see the range of possible outcomes in the markets and the economy to be extremely wide. That's why defensive strategies that minimize volatility and downside risks are the right course. |BW|

David Rosenberg is chief economist and strategist at wealth managers Gluskin Sheff and former chief economist for North America at Merrill Lynch.

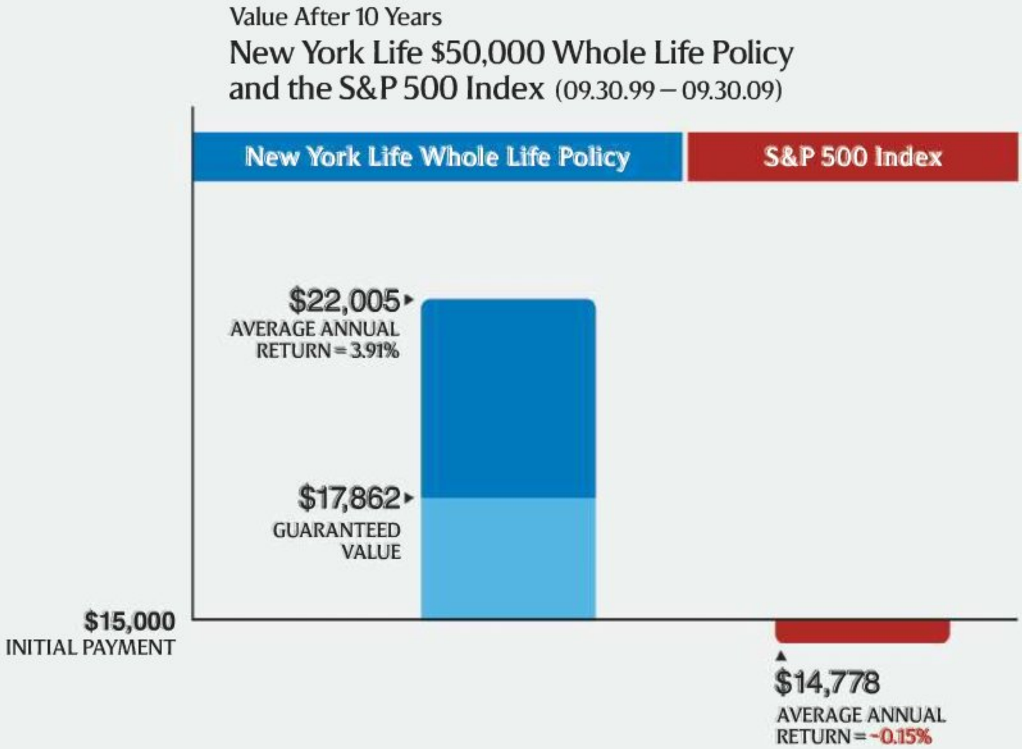
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The chart shows the difference in accumulation after ten years' time of the cash value of the whole life product versus the index's rate of return. The whole life policy was purchased in 1999 for a 35-year-old, non-smoking male; $648 annual premium plus $14,352 lump sum payment for paid up additional insurance. Return is net of annual premium obligation. Results may vary depending on age, class and gender. The 3.91% average annual rate of return and $22,005 cash value shown reflect the increase in the policy's total cash value. "Guaranteed growth" refers to the sum of the guaranteed cash value of both the base policy and the paid up additional insurance minus the initial payment ($2,862). Dividends are not guaranteed. Cash value is accessible through loans, which accrue interest, and surrenders. Both reduce the total cash value and death benefit, and unpaid loan interest could result in the policy lapsing. Cash value of a whole life insurance policy begins accumulating at the end of the first policy year. Guarantees are dependent upon the claims paying ability of the issuer. This chart also shows the hypothetical historical performance of a $15,000 investment which tracks the returns of the S&P 500 index. S&P 500® is a trademark of the McGraw-Hill Companies, Inc. The S&P 500 is an unmanaged index and is widely regarded as the standard for measuring large-cap U.S. stock market performance. Returns reflect reinvestment of all income and capital gain distribution, and an investment cannot be made directly into an index. Past performance is not indicative of future results. (Exp. 1/10) ©2009 New York Life Insurance Company, 51 Madison Avenue, New York, NY 10010

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